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# COMPARATIVE POOLING LAW: ARKANSAS AND TEXAS

Thomas A. Daily  
George A. Snell



**RULES DONE RIGHT IN ARKANSAS—COMPULSORY UNITS, INTEGRATION AND  
CROSS-UNIT WELLS, OH MY!—TOTO, WE AIN'T IN TEXAS ANYMORE**

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## INTRODUCTION

This is an article about the pooling of oil and gas interests. Oil and gas interests are pooled so that those valuable resources may be developed to their maximum potential,<sup>1</sup> without unnecessary expense<sup>2</sup> and in such a way that the cost and resulting production from the enterprise is equitably shared among all those owners of interests in the common source of supply.<sup>3</sup>

That doesn't sound like anything they do in Texas, does it? Texas<sup>4</sup> adheres to the Eleventh Commandment:<sup>5</sup> "Thou shalt honor thy Rule of Capture, even when it gets Thou into a mess." Thus, in Texas and similar jurisdictions, each leased tract is presumed to be an island, fully licensed to capture fugacious underground reserves from its neighbors,<sup>6</sup> and, when victimized by capture from an adjacent tract, to go and do likewise—capture back. The trouble is that the Rule of Capture, left to run amuck, leads to a pretty dreadful end:



<sup>1</sup> Thus avoiding the waste of those precious little molecules.

<sup>2</sup> Thus avoiding the waste of those precious American dollars.

<sup>3</sup> Thus protecting the correlative rights of all interested parties.

<sup>4</sup> And a few other jurisdictions, mostly in Appalachia.

<sup>5</sup> The one carved upon the back-side of Moses' big rock.

<sup>6</sup> Even by underground physical invasion of hydraulic fracturing fluids and propanant. See, e.g. *Costal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1, 51 Tex. Sup. Ct. J. 55 (2008).

We need not cry for poor Texas, however. Where there is a will, there is somewhat of a way. It is not always the best way, but it is better than no way at all. Even Texans cannot abide by the anarchy which inevitably follows from the Rule of Capture. To learn the Texas way of dealing with the mess, pay close attention to my colleague, George A. Snell, III. He will explain.

He will start by telling you that the Texas Legislature has never enacted meaningful compulsory pooling legislation. If you buy him a couple of beers, he might even admit that even if the Texas Legislature ever did pass such an act, the Texas Railroad Commission might refuse to enforce it.

In Texas, if an operator or group of operators wish to avoid the waste of resources and money resultant from drilling on every lease tract, not to mention the inequities of taking a first-come-first-served approach to the common underground reservoir, the operator or group of operators will largely need to do it on their own, with only a little peripheral help from the Texas Railroad Commission. George will explain all about that.

This article explores the alternative: compulsory pooling. Our example will be Arkansas, where governmental regulation of oil and gas exploration and production has become rather highly evolved.

#### **IT STARTS WITH STATUTES**

Oil and gas regulatory law is primarily accomplished by a state's oil and gas conservation agency. Different jurisdictions give different names to their administrative agencies.<sup>7</sup> Arkansas' agency is the AOGC. It is fundamental to constitutional law that administrative agencies, such as conservation agencies, have no inherent powers. Rather, those agencies are created by legislative enactments which also set out the regulatory authority of the agencies thus created. Logically, examination of a state's regulatory law should start with a review of the statutes that create and empower its conservation agency.

Arkansas' conservation act was enacted as Act No. 105 of 1939. The act, its amendments and a few subsequent additions are now codified beginning at Ark. Code Ann. § 15-72-101 through § 15-72-407 (Repl. 2009). The act was modeled after the then-existing model conservation act published by the Interstate Oil and Gas Compact. Arkansas' act has been amended, from time to time. An important amendment by the 2003 General Assembly significantly changed the statutory definition of a drilling unit. Set out below is the statute, which is the primary source of Oil and Gas Commission jurisdiction. It is redlined to highlight the 2003 amendment. The original 1939 language is stricken through, while the 2003 language is underlined:

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<sup>7</sup> i.e. Railroad Commission, Corporation Commission, Oil and Gas Board, etc.



**§ 15-72-302 Just and Equitable Shares - Preventing Waste, Avoiding Risks, Etc. - Drilling Units.**

(a) Whether or not the total production from a pool is limited or prorated, no rule, regulation, or order of the Oil and Gas Commission shall be such in terms or effect:

(1) That it shall be necessary at any time for the producer from or the owner of a tract of land in the pool, in order that he or she may obtain the tract's just and equitable share of the production of the pool, as the share is set forth in this section, to drill and operate any well or wells on the tract in addition to the well or wells as can without waste produce the share; or

(2) As to occasion net drainage from a tract unless there is drilled and operated upon the tract a well or wells in addition to the wells thereon as can without waste produce the tract's just and equitable share, as set forth in this section, of the production of the pool.

(b) (1) For the prevention of waste and to avoid the augmenting and accumulation of risks arising from the drilling of an excessive number of wells, after a hearing the commission shall establish a drilling unit or units for each pool except in those pools that, prior to February 20, 1939, have been developed to an extent and where conditions are such that it would be impracticable or unreasonable to use a drilling unit at the present stage of development.

(2) As used in this subchapter, ~~unless the context otherwise requires, "drilling unit" means the maximum area which may be efficiently and economically drained by one (1) well, and the unit shall constitute a developed unit as long as a well is located thereon which is capable of producing oil or gas in paying quantities.~~

(2)(A) As used in this subchapter, "drilling unit" means a single governmental section or the equivalent unless a larger or smaller area is requested by an owner, as defined in § 15-72-102, within the drilling unit to be established and a larger or smaller area is established by order of the commission. The drilling unit shall constitute a developed unit as long as a well is located thereon that is capable of producing oil or gas in paying quantities.

(B) The commission shall have the continuing authority to:

(i) Designate the number of wells that may be drilled and produced within a drilling unit; and

(ii) Regulate the spacing among multiple wells drilled and produced within a drilling unit.

~~(c) Each well permitted to be drilled upon any drilling unit shall be drilled approximately in the center thereof, with such exception as may be reasonably~~

~~necessary where it is shown, after notice and upon hearing, and the commission finds, that the unit is partly outside the pool or, for some other reason, a well approximately in the center of the unit would be nonproductive or where topographical conditions are such as to make the drilling approximately in the center of the unit unduly burdensome. Whenever an exception is granted, the commission shall take action to offset any advantage which the person securing the exception may have over other producers by reason of the drilling of the well as an exception, and so that drainage from developed units to the tract with respect to which the exception is granted will be prevented or minimized and the producer of the well drilled as an exception will be allowed to produce no more than his just and equitable share of the oil and gas in the pool, as such share is set forth in this section.~~

(c) (1) Each well permitted to be drilled upon any drilling unit shall be drilled at a location that is in compliance with rules adopted by the commission, with such exception as may be reasonably necessary where it is shown, after notice and upon hearing, and the commission finds that a well drilled at a different location is likely to prevent waste or protect correlative rights of owners within the unit, or both.

(2) Whenever an exception is granted, the commission shall take action to offset any advantage that the person securing the exception may have over other producers by reason of drilling the well as an exception, and so that drainage from developed units to the tract with respect to which the exception is granted will be prevented or minimized and the producer of the well drilled as an exception will be allowed to produce no more than his or her just and equitable share of the oil and gas in the pool, as the Share is set forth in this section.

(d) (1) Subject to the reasonable requirements for prevention of waste, a producer's just and equitable share of the oil and gas in the pool, also sometimes referred to as a tract's just and equitable share, is that part of the authorized production for the pool, whether it is the total that could be produced without any restriction on the amount of production or whether it is an amount less than that which the pool could produce if no restriction on amount were imposed, which is substantially in the proportion that the quantity of recoverable oil and gas in the developed area of the producer's tract in the pool bears to the recoverable oil and gas in the total developed area of the pool, insofar as these amounts can be practically ascertained.

(2) To that end, the rules, regulations, permits, and orders of the commission shall be such as will prevent or minimize reasonably avoidable net drainage from each developed unit, that is, drainage that is not equalized by counter drainage and will give to each producer the opportunity to use his or her just and equitable share of the reservoir energy.

~~(e) The commission may, after public hearing held pursuant to notice given as required by law and by any rules or orders of the commission, establish a drilling unit as defined in subsection (b) of this section for an exploratory well to be drilled therein. Any drilling unit so established shall be comprised of a governmental section or the equivalent thereof determined by the commission to be prospective of oil or gas, or both, and the commission shall have the authority to integrate separately owned tracts embraced therein when the owners thereof fail or refuse voluntarily to do so, provided that persons who own at least an undivided fifty percent (50%) interest in the right to drill and produce oil or gas, or both, from the total proposed unit area agree thereto. However, any such order of the commission and drilling unit established for exploratory purposes thereunder shall remain in force for a period no longer than the later of one (1) year following the effective date thereof or one (1) year following the cessation of drilling operations or production within the unit, whereupon the order of the commission and the provisions thereof shall automatically terminate.~~

(e)(1) After public hearing held pursuant to notice given as required by law and by any rules or orders of the commission, the commission may establish a drilling unit as defined in subsection (b) of this section for an exploratory well to be drilled therein.

(2) Any drilling unit so established shall be composed of a governmental section or the equivalent thereof unless a larger or smaller area is requested by an owner, as defined in § 15-72-102, within the drilling unit to be established and a larger or smaller area is established by order of the commission, determined by the commission to be prospective of oil or gas, or both. The commission shall have the authority to integrate separately owned tracts embraced therein when the owners thereof fail or refuse voluntarily to do so provided that persons who own at least an undivided fifty percent (50%) interest in the right to drill and produce oil or gas, or both, from the total proposed unit area agree thereto.

(3) However, any such order of the commission and drilling unit as established for exploratory purposes thereunder shall remain in force for a period no longer than the later of one (1) year following the effective date thereof or one (1) year following the cessation of drilling operations or production within the unit, whereupon the order of the commission and the provisions thereof shall automatically terminate.

Notice that under either version of this Arkansas statute, units are formed by order of the Commission (AOGC"), not by private agreement between lessor and lessee, or among multiple lessees. Therein lies the first big difference between Texas and Arkansas. In Arkansas, the AOGC has the power and duty to control oil and gas development by prescribing a uniform, efficient pattern of drilling units. Given the prevailing attitude of AOGCs over the past 50 years or so, that means that unit

boundaries will touch adjoining unit boundaries, leaving no acreage outside of some unit or potential unit, at least until that acreage has been tested unsuccessfully to the point where it is clearly geologically condemned. In Texas, on the other hand, where units are formed by voluntary action, open acreage between units<sup>8</sup> is not uncommon.

Arkansas' original 1939 statutory language defined a drilling unit as the "maximum area which may be efficiently and economically drained by one (1) well." I sometimes describe this kind of statutory language as calling for the formation of "geological units." Of course, that determination, done correctly, would require a thorough understanding of the geology and reservoir characteristics of every productive formation.

There has historically been a real problem with geological units in Arkansas, particularly North Arkansas. Arkansas drilling units are usually formed long before there is sufficient geological and/or engineering information available to intelligently make a determination about unit size and placement. Complicating that problem is the happy news that significant portions of North Arkansas' Arkoma Basin are underlain with multiple reservoirs, stacked at different depths beneath the surface. These multiple reservoirs exhibit different characteristics like porosity, permeability and physical boundaries, requiring different unit configurations, at different depths, if the statutory requirement was truly observed.

In North Arkansas that would have caused a real mess. Establishing simple units to cover all depths was propitious, though it did not comply with the statute at that time. Among other benefits, it facilitated the commingling multiple pay zones within depleting well bores so as to extend the life of those wells and, ultimately, prevent the waste of gas from premature well plugging.<sup>9</sup>

Long ago, AOGC quit trying to adhere to the literal requirements of that Arkansas' statute. In North Arkansas where virtually all production is of dry natural gas, the AOGC formed square-shaped units to coincide with Arkansas' approximately 640 acre governmental sections. In South Arkansas, where most production is of oil, square or rectangular units ranging in size from five acres to 160 acres became the rule. In almost every such case those "stand-up" or "lay-down" oil units were formed out of one or more regular governmental subdivisions.<sup>10</sup> The size of such units seemed to be influenced mostly by the reservoir's depth rather than its drainage characteristics. Regardless, the AOGC held fast to its aversion to open acreage between units, thus requiring South Arkansas units to also be configured so that no such window acreage space was permitted.

The 2003 statutory amendment retroactively made us honest. Now, officially, geology has nothing to do with unit size or shape. Now units are officially 640 acre governmental sections. Drainage has nothing to do with the matter. Exceptions are

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<sup>8</sup> We call it "window acreage."

<sup>9</sup> To corrupt a phrase from a former First Lady, and Texan, "let no molecule be left behind."

<sup>10</sup> i.e. a quarter, quarter, quarter section contains 10 acres.



permitted, but only upon request of an owner, “as defined in § 15-72-102.” That section defines owner as a “person having the right to drill and produce,” i.e. a working interest owner. Such exceptions are routinely made in South Arkansas oil fields, so units covering lands there are created just as before, primarily influenced by reservoir depth.

Every bit as significant, the 2003 statutory amendment specifically empowered the AOGC to authorize multiple unit wells, and regulate their locations within units. The previous statutory reference to “a single well” suggested that such authority may not have existed, though the AOGC was beginning to find excuses to permit at least some increased density wells, particularly in areas lacking much reservoir permeability. We will discuss regulation of well density later in this article.

Another important set of statutes, also part of Act No. 105 of 1939, enable integration of non-consenting owners, a process called “force-pooling” in most other jurisdictions where it is permitted by statute:<sup>11</sup>

#### **§ 15-72-303 Authority to Integrate Production in Drilling Units.**

(a) When two (2) or more separately owned tracts are embraced within an established drilling unit, when there are separately owned interests in all or part of the drilling unit, or when there are separately owned tracts and separately owned interests in all or part of such a drilling unit, the owners thereof may voluntarily pool, combine, and integrate their tracts or interests for the development or operation of that drilling unit.

(b) When the owners fail or refuse voluntarily to integrate their interests, upon the application of any such owner or operator, the commission, for the prevention of waste or to avoid the drilling of unnecessary wells, shall enter its order integrating all tracts and interests in the drilling unit for the development or operation of the drilling unit and the sharing of production from the drilling unit.

#### **§ 15-72-304 Integration Orders Generally.**

(a) All orders requiring integration shall be made after notice and hearing and shall be upon terms and conditions which are just and reasonable and which will afford the owner of each tract or interest in the drilling unit the opportunity to recover or receive his just and equitable share of the oil and gas in the pool without unnecessary expense and will prevent or minimize reasonably avoidable drainage from each developed unit which is not equalized by counter drainage.

(b) In the event the drilling of a well has not been commenced, or if commenced, the well has not been completed as a well capable of producing oil

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<sup>11</sup> You will probably not be surprised to hear that force-pooling is virtually non-existent in Texas.

and gas in commercial quantities on the lands comprising the drilling unit on the effective date of the order requiring integration, the order shall:

**(1)** Authorize the drilling or completion and the equipping and operation of a well on the drilling unit;

**(2)** Provide who shall drill, complete, and operate the well;

**(3)** Prescribe the time and manner in which all owners in the drilling unit who may desire to pay their share of the costs of such operations and participate therein may elect to do so;

**(4)** Provide that an owner who does not affirmatively elect to participate in the risk and cost of the operations shall transfer his rights in the drilling unit and the production from the unit well to the parties who elect to participate therein for a reasonable consideration and on a reasonable basis, which in the absence of agreement between the parties, shall be determined by the commission. The transfer may be either a permanent transfer or may be for a limited period pending recoupment out of the share of production attributable to the interest of the nonparticipating owner by the participating parties of an amount equal to the share of the costs that would have been borne by the nonparticipating party had he participated in the operations, plus an additional sum to be fixed by the commission.

**(c)** In the event there is a well capable of producing oil or gas in commercial quantities on the lands comprising the drilling unit on the effective date of the order requiring integration, the order shall:

**(1)** Authorize the operation of the well;

**(2)** Provide who shall operate the well; and

**(3)** Provide that, within the time stipulated in the order, any owner in the drilling unit who did not participate in the drilling of the well shall either reimburse the drilling parties in cash for his share of the actual cost of drilling, completing, and equipping the well or shall transfer his rights in such drilling unit and the production from the well to the drilling parties until those parties have received out of the share of production attributable to the interest so transferred an amount equal to the share of the costs that would have been borne by the transferring party had he participated in drilling, completing, equipping, and operating the well, plus an additional sum to be fixed by the commission.

**(d)** In the event there is an unleased mineral interest or interests in any drilling unit, the owner thereof shall be regarded as the owner of a royalty interest

to the extent of a one-eighth (1/8) interest in and to the unleased mineral interest. This royalty interest shall not be affected by the provisions of subsections (b) and (c) of this section.

Now we can better understand why spaces of window acreage between units are commonplace in Texas, but nearly non-existent in Arkansas? The answer is simple. If an owner refuses to lease or participate in an Arkansas unit, you integrate him, i.e. force him into the unit. If an owner refuses to lease or participate in a Texas unit, where they do not have force-pooling, you do the only thing left to do; you leave him out.

Will the little molecules of oil or gas below the non-consenting Texas owner ever be produced, or will they be left behind, wasted? To answer that question we would need a lot of information about the location of existing wells, along with the permeability and other drainage characteristics of the particular reservoir in which the well is completed. We know one thing for sure, however. The non-consenting Texas owner will never be paid for any part of those molecules.

To summarize, Arkansas and Texas laws of pooling relating to about as different, as are night and day. We form compulsory units, they do not. We integrate non-consenting owners into those units, they do not. If you understand those two fundamental statutory differences, you can probably understand all the other subtle little differences, as well.

#### **OUR DISCUSSION CONTINUES WITH RULES, REGULATIONS AND ADMINISTRATIVE ORDERS**

Like virtually every oil and gas producing jurisdiction, Arkansas' actual hands-on regulation is done by an administrative agency, empowered to so regulate by legislative enactments, including those discussed above.

The AOGC regulates about every conceivable aspect of the oil and gas exploration, and production process. We will concentrate on that aspect of its jurisdiction which relates to pooling.

The AOGC has become a modern and relatively user-friendly agency, of late. Its website, [www.aogc.state.ar.us](http://www.aogc.state.ar.us), contains a wealth of information including, importantly, its current Rules and Regulations and Field Rule Summaries. Field Rules are the collection of AOGC orders which create drilling units in South Arkansas and much of the traditional Arkoma Basin in North Arkansas. Here is how it works.

AOGC general rule B-38 provides as follows:

#### **RULE B-38: ESTABLISHMENT OF FIELD RULES**

- a) An application for the purpose of establishing field rules, regulations, and well spacing and drilling units for a new reservoir or pool, except within the

covered lands specified in General Rule B-43 or General Rule B-44, shall be submitted, in accordance with General Rules A-2, A-3, and applicable hearing procedures, to the Commission within six months after the initial completion of the discovery well in a pool or reservoir or after the drilling of three wells, whichever occurs first. Prior to receipt of an application, no further permits to drill more than three wells in the same source of supply in the exploratory area as defined by the Director shall be issued.

- b) Upon receipt by the Commission of an application for public hearing to establish field rules, regulations, well spacing, and drilling units for a reservoir, additional permits beyond the initial three wells may be issued to that reservoir or pool, provided the well permit applications comply with the drilling unit size and well location provision as contained in the application. Permits may continue to be issued until a hearing is held and a decision rendered.
- c) The Commission may, after notice and hearing in accordance with General Rule A-2, A-3 and other applicable hearing procedures, grant exceptions to this rule, provided such exceptions will create neither waste nor hazards conducive to waste.

Thus, within the first-occurring of six months or completion of three wells in a common source of supply of oil and/or gas, an application must be filed with the AOGC for the purpose of establishing field rules. Those field rules will then be contained within the order issued by the AOGC, after hearing, in response to that application. That order will specify the lands to be included within the field, the size and pattern of the field's units, well location provisions within the units and other regulations applicable to wells within the field.

6	5	4	3	2	1
7	8	9	10	11	12
18	17	16	15	14	13
19	20	21	22	23	24
30	29	28	27	26	25
31	32	33	34	35	36

Figure 1, Standard Township and Range to demonstrate field rule extensions

Frequently, field rules will provide that the field will consist of the units containing the discovery well(s) and “extensions thereto.” That so-called “automatic extension” provision causes the field to expand, Scrabble-board style, as future development occurs. It works like this. Assume that the initial field rule order provides for 640 acre, governmental section units, the first of which, section 15 of a standard township and range, contains the discovery well. As is shown in Figure 1, Section 15 is directly offset by Sections 10, 14, 22 and 16, with four corner offsets consisting of Sections 9, 11, 21, and 23. Each of those offsetting sections is a potential extension, and thus is eligible to become part of the field, if and when a well is completed in that offset. For example, assume that the next well is drilled in Section 11, a corner offsetting extension to Section 15. That well completion will then create a new group of eligible extensions (Sections 1,2,3,12 and 13 which are offsets to Section 11). (Of course, Sections 10,14 and 15 are also offsets to Section 11, but Section 15 was already within the field and Sections 10 and 14 were already extension. In the same fashion, as additional wells are completed, the field grows, as does the list of eligible extensions.

Sooner or later, when development in the area is dense, fields may grow so close together that some governmental sections become potential extensions to multiple fields. In North Arkansas, where field rules are pretty much identical, substantively, it probably does not matter which field those extensions join, though at one time, when production allowables were assigned to each field based upon purchaser nominations for gas from wells within the field, the choice was important. In South Arkansas, where working interest owners request fields to provide for units smaller than the statutory default of a 640 acre governmental section, an operator may be motivated to select one adjoining field over another because of the operator’s preferred unit size.

If one needs to better understand the substance of the field rules of a particular well or prospective well, the Field Rules Summary tab on the AOGC website is the place to go. However, it should only be used as a gateway to the actual field rule orders (also available on the website) since the “summaries” are prepared by non-lawyer staff members and may be incomplete or misleading.

This whole field rule business makes about as much sense as the Internal Revenue Code. It is what it is now, because of the way it was before, and no one bothered to change it. Fortunately, the AOGC has found a better way, recently. In Arkansas’ two most recent successful resource plays, the Fayetteville Shale Play<sup>12</sup> and the Middle Atoka Play,<sup>13</sup> the AOGC chose to depart from the field rule model, in favor of general rules containing spacing, location and well density provisions for over the anticipated entire extent of the play.<sup>14</sup>

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<sup>12</sup> In North Central Arkansas.

<sup>13</sup> In the extreme southwest corner of the Arkansas Arkoma Basin.

<sup>14</sup> AOGC General Rules B-43 and B-44, respectively.

It is reasonable to expect that the AOGC will enact a general rule merging existing field rules in those North Arkansas Arkoma Basin Fields which are not presently within the areas defined by General Rules B-43 and B-44 in the not-to-distant future. Meanwhile, we will have to parse through the rules of the individual fields to confirm unit size and configuration as well as well location requirements.

In summary, Arkansas units are formed by governmental action, embodied either in field rules or in general rules of the AOGC. Units outside of the B-43 and B-44 areas and outside of existing fields might be created voluntarily by the exercise of voluntary pooling agreements, but even then, AOGC General Rule B-38 still requires an application for field rules to be filed, giving the AOGC final say over the matter. For that reason, no one bothers to form a voluntary unit.

Oil and Gas leases in use in Arkansas do contain pooling clauses. Here is a typical example:

Lessee hereby is given the right, at its option, at any time and whether before or after production, to pool for development and operation purposes all or any part or parts of leased premises or rights therein with any other land in the vicinity thereof, or with any leasehold, operation or other rights or interests in such other land so as to create units of such size and surface acreage as Lessee may desire but containing not more than forty-five (45) acres; provided, however, a unit may be established hereunder containing not more than 640 acres plus 10% acreage tolerance if unitized only as to gas rights or only as to gas and gas-condensate, except that units pooled for oil or oil and gas for or in conjunction with the repressuring, pressure maintenance, cycling and secondary recovery operations or any one or more of same may be formed to include not more than 320 acres. Each unit shall be created by Lessee's recording a Declaration of Pooling containing a description of the unit so created.

Operations on any part of any lands so pooled shall, except for the payment of royalties, be considered operations on leased premises under this lease, and, notwithstanding the status of a well at the time of pooling, such operations shall be deemed to be in connection with a well which was commenced on leased premises under this Lease. The term "operations" as used herein shall include, without limitation, the following: Commencing construction of roadways, preparation of drillsite, drilling, testing, completing, reworking, recompleting, deepening, plugging back, repressuring, pressure maintenance, cycling, secondary recovery operations, or the production of oil or gas, or the existence of a shut-in well capable of producing oil or gas.

There shall be allocated to the portion of leased premises included in any such pooling such proportion of the actual production from all lands so pooled as such portion of leased premises, computed on an acreage basis, bears to the entire acreage of the lands so pooled. The production so allocated shall be

considered for the purpose of payment or delivery of royalty to be the entire production for the portion of leased premises included in such pooling in the same manner as though produced from such portion of leased premises under the terms of this Lease.

The question how to resolve conflicts between such express lease language and the orders of the AOGC was resolved, in favor of the AOGC order in *Gordon v. Crown Central Petroleum Co.*, 284 Ark. 94, 679 S.W.2d 192 (1984). In that case Crown Central had taken a lease from Mrs. Gordon containing a Pooling Clause similar to the one set out above. However, the AOGC's order forming the drilling unit in question specified an oversized governmental section, containing 726.92 acres, well in excess of the 640 plus 10% acres allowed by the Pooling Clause.

The Supreme Court held that the restrictions and requirements of the pooling clause were negated by the AOGC's order. Drawing the distinction between voluntary pooling<sup>15</sup> and compulsory pooling under the AOGC's statutory authority, the court determined that, by force majeure, the Pooling Clause was trumped by conflicting provision of the AOGC's order. While the facts of *Gordon* were limited to the Pooling Clause's restriction on unit size, its holding can logically be extended to other requirements of the Pooling Clause, such as the requirement that a declaration of pooling be filed by the lessee, as long as an AOGC rule or order formed the unit in question, which is virtually always.

#### **ARKANSAS PERMITS FORCE-POOLING (INTEGRATION) OF NON-CONSENTING OWNERS INTO DRILLING UNITS**

It is often difficult to obtain oil and gas leases or participation commitments from every owner of unleased mineral or leasehold rights in an entire drilling unit. Therefore, the AOGC has the authority to compel the inclusion of non-consenting interests into the unit. That process is called Force-Pooling in most jurisdictions which allow it, but in Arkansas it is called "integration." It is authorized by statute.<sup>16</sup>

The integration process really begins months before the formal filing of the application. An applicant for integration is required by the AOGC to make documented good faith efforts to secure a lease or participation commitment from each such unleased mineral owner and each non-consenting leasehold owner.<sup>17</sup> After the prospective applicant for integration secures all the leases and commitments which it can secure without AOGC help, it will file its integration application.

That application must be filed at least 20 days prior to the AOGC meeting at which it will be heard.<sup>18</sup> The applicant is also required to mail notice of its application to all

<sup>15</sup> Which, as observed above, can almost never occur in Arkansas.

<sup>16</sup> Ark. Code Ann. §§ 15-72-303-304 Repl. 1994, set out above.

<sup>17</sup> See AOGC General Rule A-3 (b)(2)(G) & (H).

<sup>18</sup> The AOGC currently meets monthly, except for November/ December, normally beginning on the 4th Tuesday of the month. The November/ December meeting is combined and specially scheduled for either the last Tuesday in

interested parties<sup>19</sup> and publish notice of its application in a newspaper of general circulation in the county containing the unit, at least 10 days prior to the hearing.

Before the AOGC grants an application for integration it weighs the sufficiency of the applicant's efforts to secure leases or participations on its own. It then considers evidence of the prevailing bonuses and royalties contracted for in the unit. Finally, the AOGC considers evidence of the expected geological nature of the proposed well, and especially the extent of geological risk involved in the venture.<sup>20</sup>

The integration order will require each non-consenting owner to make an election.<sup>21</sup> Unleased mineral owners get three options:

- 1) lease to the unit operator on terms determined to be fair and reasonable by the AOGC;<sup>22</sup>
- 2) participate in the cost of drilling, equipping and producing the well; or
- 3) receive a 1/8 royalty on their proportionate interest in the well until and unless the other 7/8 of the well's revenue equals a sum which is determined as follows: Drilling and equipping costs times X% plus operating costs times 100% ("X" is usually 400% or 500% as determined by the AOGC, to compensate the operator for taking the financial risk of drilling the well).<sup>23</sup>

After this sum is recovered, each non-consenting owner becomes a participant in the well, proportionately entitled to share in future revenue and proportionately liable for future well costs.<sup>24</sup> This option is called "going non-consent."

If an unleased mineral owner fails to affirmatively elect from the above options, she will be deemed to have selected option one,<sup>25</sup> i.e., the lease. If a non-consenting working interest owner fails to affirmatively elect one of the three options, he or she will be deemed to have gone non-consent.

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November or the first Tuesday in December. Its exact current hearing schedule, as well as the current agenda is available from its website.

<sup>19</sup> Including unleased mineral owners and non-consenting working interest owners.

<sup>20</sup> See Ark. Code Ann. § 15-72-302 (d)(2) Repl. 1994).

<sup>21</sup> See Ark. Code Ann. § 15-72-304 Repl. 1994).

<sup>22</sup> The oil and gas lease option is the modern version of the permanent transfer of the non-consenting interest authorized by Ark. Code Ann § 15-72-304 (b)(4), and only is permitted if there is no producing well within the unit at the time of the integration order. If the unit does contain one or more producing wells, such permanent transfer is not authorized by Ark. Code Ann § 15-72-304(c) (3), so any lease option included in the order must be purely voluntary, the default election being non-consent, in that case.

<sup>23</sup> See Ark. Code Ann. § 15-72-304(b)-(d) Repl. 1994).

<sup>24</sup> See Ark. Code Ann. § 15-72-305 (d)(1) Repl. 1994).

<sup>25</sup> The lease, generally on the same terms, including bonus as the most favorable terms contracted for by any owner within the unit who leased in an arms-length transaction.



The AOGC's integration order will require that operations be conducted pursuant to an Operating Agreement<sup>26</sup> approved by the AOGC. The AOGC's approved JOA is on a A.A.P.L Form 610-1982, but has been substantially amended to include many of the provisions of the 1989 JOA form. In 2006, the AOGC, working with an ad hoc committee of industry representatives, adopted a standard form Operating Agreement for use in its integration orders.<sup>27</sup>

#### **THE AOGC REGULATES THE NUMBER AND SPACING OF WELLS WITHIN UNITS**

At the beginning of this article we reviewed ARK. CODE ANN. § 15-72-302 as we discussed Arkansas' statutory language relative to the size and shape of drilling units. That same statute, as amended in 2003, gives the AOGC broad discretion in determining the number and spacing of wells within units:

- B (2)(b) The commission shall have the continuing authority to:
- (i) Designate the number of wells that may be drilled and produced within a drilling unit; and
  - (ii) Regulate the spacing among multiple wells drilled and produced within a drilling unit.
- (c) (1) Each well permitted to be drilled upon any drilling unit shall be drilled at a location that is in compliance with rules adopted by the commission, with such exception as may be reasonably necessary where it is shown, after notice and upon hearing, and the commission finds that a well Drilled at a different location is likely to prevent waste or protect correlative rights of owners within the unit, or both.
- (2) Whenever an exception is granted, the commission shall take action to offset any advantage that the person securing the exception may have over other producers by reason of drilling the well as an exception, and so that drainage from developed units to the tract with respect to which the exception is granted will be prevented or minimized and the producer of the well drilled as an exception will be allowed to produce no more than his or her just and equitable share of the oil and gas in the pool, as the Share is set forth in this section.

General Rules B-43 and B-44 specify the number of wells permitted to be drilled in each unit, without securing special exception orders within the respective areas prescribed by those rules. Outside the areas covered by those general rules, the number of wells permitted within any common source of supply within a unit is covered by the field rules of the field within which the unit is located. These field rules also specify the

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<sup>26</sup> But referred to in industry jargon as a "JOA."

<sup>27</sup> That standard form is currently available, on line, from the AOGC website.

distance that any well must be offset from all unit boundaries, unless a location exception is granted for an encroaching well. In the traditional North Arkansas Arkoma Basin, only one well is normally allowed to produce, at any one time from each separate common source of supply which is productive within the unit. Each separate stratigraphic reservoir constitutes a separate common source of supply. Also, a single stratigraphic reservoir, divided by a flow barrier<sup>28</sup> can constitute multiple common sources of supply.

The AOGC sometimes grants exceptions to the above density requirements, so as to permit "increased density" wells. Its General Rule D-19 provides a procedure for obtaining such exceptions administratively<sup>29</sup> under certain limited circumstances.

AOGC General Rule B-44, which covers the Middle Atoka Area in the southwest corner of the Arkoma Basin permits up to 16 Middle Atoka wells, per 640 acre governmental section unit. Each such well is required to be at least 560 feet distant from all other wells within the unit and 560 feet distant from all exterior unit boundaries. Note that the same rule treats all of the separate sandstone reservoirs within the gross Middle Atoka Interval as a single common source of supply, which in reality, they are not. The AOGC's logic there is that while Middle Atoka wells often exhibit extremely limited ability to drain large areas, they often encounter multiple reservoirs at different depths. To accommodate the surface owners, these wells should be encouraged to each produce from multiple reservoirs, commingled, eventually, instead of permitting additional surface disturbances.

The calculation of the number of permitted wells within the General Rule B-43 area is more complicated. We will first discuss well location provisions, for background. Then when we return to the calculation of the number of wells permitted in the General Rule B-43 area it will almost make sense.

AOGC General Rule B-3 (a)(2) defines the term "well location" as follows:

(2) For the purpose of well setback provisions, except in uncontrolled areas, well location is defined as the actual physical location of the completed interval in the well, projected to the surface, as follows:

A. In a vertically drilled well without a directional survey, the well location is the surface location. In a vertically drilled well, the well location is the location of the perforated interval of the well bore, projected vertically to the surface;

B. In a directionally drilled well, the well location is the location of the midpoint of the perforated interval of the producing formation, as calculated from the directional survey, projected vertically to the surface;

---

<sup>28</sup> Such as a sealing fault.

<sup>29</sup> Meaning approved by AOGC staff without need for hearing.

C. In a horizontally drilled well, the well location is the entire perforated length of the lateral section of the well bore, as shown on a directional survey, projected vertically to the surface.

Virtually all wells within the General Rule B-43 area are horizontal wells, completed within the Fayetteville Shale Formation. Thus, the location of each such well is every point along a line connecting the entire perforated interval of the well.<sup>30</sup> General Rule B-43 requires well locations, as thus defined to be at least 560 feet apart and at least 560 feet from all unit boundaries. However, General Rule B-43(o) permits the drilling and production of cross-unit wells.

Cross-unit wells are very good thing. We are proud that they were invented in Arkansas and that much of the economic success of the Fayetteville Shale Play can be attributed, at least in part, to their wide use. Here is how the cross-unit well works. Notwithstanding the above discussed 560 foot unit boundary setback discussed above, a well which encroaches upon, or even crosses a unit boundary will be permitted as a shared cross-unit well. In order to determine the sharing formula between the participating units we draw an elongated circle-like figure<sup>31</sup> which is exactly 560 feet from the horizontal well bore, as defined by the rule. The resultant figure somewhat resembles a Band-Aid, so we have given our picture the name "Band-Aid Map." Next, calculate the entire acreage within the Band-Aid. Then, calculate the acreage within the Band-Aid which is within each affected unit. Finally divide each unit's acreage number by the total acreage number, yielding percentages.<sup>32</sup> If that was confusing, Figure 2, below might help.

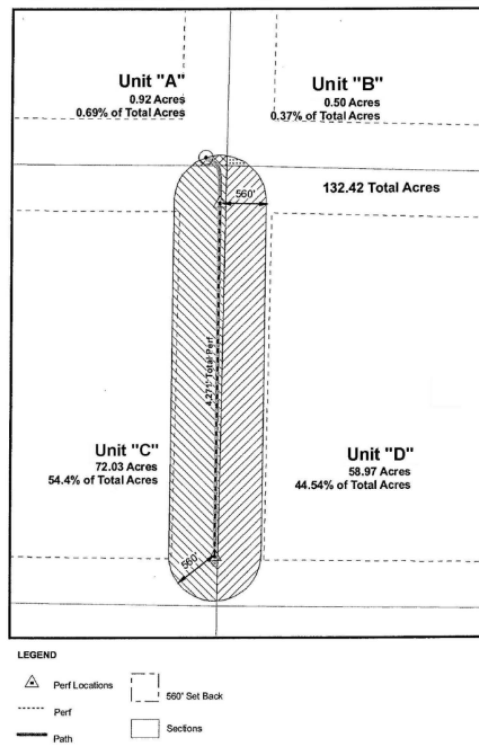
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<sup>30</sup> I.e. the line connecting the heel perforation with the toe perforation, and every perforation in between.

<sup>31</sup> Technically called an ellipse.

<sup>32</sup> If, at this point, you add all the total percentages you should get 100.00000%. Any other answer is unacceptable and you should start over.

Figure 2. Hypothetical Band-Aid map, showing calculation of unit sharing formula

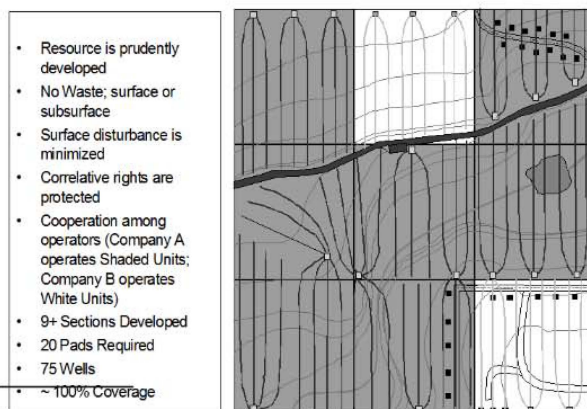


When we consider that a 640 acre governmental section is a square mile,<sup>33</sup> and that drillers can now easily drill a horizontal well in the Fayetteville Shale with a productive lateral interval approaching two miles in length, the need for cross-unit well readily becomes apparent. Indeed regardless of their length, cross-unit wells are needed to prevent gas reserves from being stranded near unit boundaries<sup>34</sup> in this extremely low-permeability reservoir. The problem comes from the way the AOGC insists upon counting wells. Using the definition of the well's location as every point along the well's productive interval, and disregarding, altogether, the perfectly good Band-Aid, the well shown in Figure 2 is assigned only to Unit "C", even though it is owned, in varying percentages, by four separate units. However, if that well's heel perforation was located slightly to the northwest (in Unit "A") and then its orientation was slightly to the southeast, so that it crossed into Unit "C" and then into Unit "D," it would be counted against the 16 well limit of each of those three units. Go figure.

Moving the well, as I hypothesized, would, of course, change its Band-Aid just slightly. Still it is a bit drastic to take a well which was counted against the limit of only one unit, and, by that simple change, count it against three. Indeed, it is difficult to imagine how only one well could ever be counted as three wells. I said Arkansas' regulation of Oil and Gas exploration and production was good. I never said it was perfect.

Nevertheless, the cross-unit well is a great invention which is here to stay. These days approximately 75% of all wells drilled in the Fayetteville Shale Play are cross-unit wells. Figure 3 shows what that looks like.

**Figure 3. End of the game development, using cross-unit wells**



<sup>33</sup> I.e. one mile alc

<sup>34</sup> I.e. wasted.

Outside of the areas covered by AOGC General Rules B-43 and B-44, the required well setback distance will be found in the field rules. Most of the North-Arkansas field rules specify that non-exceptional wells must be located at least 1,320 feet from all unit boundaries. In South Arkansas it varies, largely with unit size and shape.

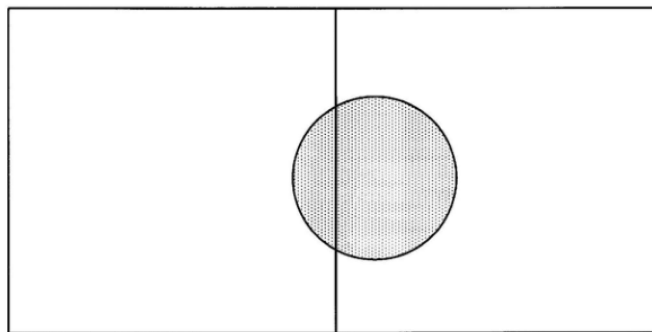
In either case, location exceptions are commonly sought, and most often granted. AOGC general rule B-40 provides a process where most of those may be obtained administratively, if they are not opposed.

Essentially, there are two options with a location exception. A well with an exceptional location can be owned, entirely, by the unit within which it is located. However, in most cases, it will suffer a reduction in its production allowable to compensate for its encroachment upon the neighboring unit. The arithmetic works like this. If the permitted non-exceptional location is 1,320 feet from all unit boundaries, and if the geologist insists upon drilling 990 from the west unit line, anyway, muttering something about not wanting to be faulted-out, he may do so. However, under the penalty provisions of General Rule B-40, his production allowable will be calculated by multiplying a normal allowable by the fraction  $990/1,320$ , or  $(3/4)$ . By the same token, he may secure a permit to drill 50 feet off the unit line, should he willing to live with  $50/1,320$  of a normal production allowable. Should our geologist spot his well so that it encroaches upon two unit lines, each penalty is calculated separately, and then they are added together. Thus, a well located 990 feet from both the north and west unit lines would receive a 50% allowable (two  $\frac{1}{4}$  penalties added together).

The second way to secure a location exception is to agree to share the off-pattern well with the section(s) encroached upon. This is similar to the Band-Aid delimited cross-unit wells in the Fayetteville Shale Play. Assuming a vertical well, a circle with a radius equal to the permitted set-back distance is projected around the well's location. That circle's area is calculated and then apportioned among the units which it overlays, just like the Band-Aid. Figure 4 will help you visualize this.

**Figure 4.**  
shared well

**Vertical**



## **CONCLUSION**

In Texas they roast chunks of cow over mesquite until just chewable. In Arkansas we hickory-smoke succulent pork butts until they may be gently pulled-to-pieces. Mysteiously, both processes are called barbecue, though they are different. There are also differences in the way we pool oil and gas interests.

## POOLING OIL AND GAS LEASES IN TEXAS

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It is easier to live with your own poverty if your neighbor isn't too prosperous.

A thoroughly wise man knows how to play the fool on occasion.

I wish my grandfather had been a miser.

Customers and kids have this in common: They both need education.

Ten words that will change your life: If it is to be, it is up to me.

## INTRODUCTION

The purpose of this paper is three fold. First, I will summarize the familiar important rules concerning voluntary pooling in Texas. Voluntary/contractual pooling has been practiced in Texas for many years. The Texas Legislature, for reasons that can be discussed by others, has elected not to enact a force pooling procedure such as has been enacted in many other oil and gas producing states. The rules concerning voluntary/contractual pooling have dealt with this traditional fact situation:

A vertical well on a drillsite tract which does not contain sufficient surface acres to allow the well to receive a full allowable.

Thus additional tracts are joined to the drillsite tract by pooling so that the well can produce at its maximum potential.

The second part of this paper will deal with issues that are not common and have not been fully developed by Texas case law. The factual situation is the drilling of a horizontal well, a well which commences drilling downward but which at a point angles such that it becomes horizontal, where most if not all of the production comes from the horizontal drill stem. In attempting to fairly share production from the horizontal well, operators are applying personal property concepts such as confusion of goods and commingling. Applying these issues takes us to the "edge of pooling".

In the third part of this paper I summarize the pooling procedures utilized by the following states:

California, Utah, Montana, North Dakota, Wyoming, Colorado, Kansas, Oklahoma, New Mexico, Texas, Arkansas, Louisiana, Mississippi, Michigan, New York and Pennsylvania.

Emphasis is placed on understanding the difference between voluntary pooling and forced pooling.

### I. THE COMMON LAW

#### A. THE NON-APPORTIONMENT RULE

Japhet v. McRae, 276 S.W. 669 (Tex. Comm'n App. - 1925, judgm't adopted)

Each mineral owner in a drillsite tract is entitled to receive his proportionate part of all royalty. If land subject to an oil and gas lease is later subdivided, royalty from production from the drillsite is payable only to the owners of that tract. The exceptions are an entirety clause, community lease, or pooling, all of which will be discussed.

In the case of a vertical well, where there is only one drillsite, this rule is easy to apply. However, where you have multiple drillsites because of a horizontal well and the exact location of the fractures from which production is obtained cannot be determined, then application of the rule of non-apportionment becomes a problem.

#### B. DUTY OF LESSEE TO LESSOR IS GOOD FAITH, NOT FIDUCIARY

Vela v. Pennzoil Producing Co., 723 S.W.2d 199 (Tex. App. - San Antonio 1986, writ ref'd n.r.e.)

The standard of lessee as fiduciary is too strict. This is because the lessee has not undertaken to manage and develop the property for the sole benefit of the lessor. The lessee has a substantial interest that must be taken into account, and it should not be required to subordinate its own interest to the interest of the lessor. Because the obligation to pool is an express one, the reasonable prudent operator standard for implied covenants does not apply.

Because the lessee has unilateral power to pool and there are situations where the interest of lessor and lessee can diverge, Texas court impose an overlying duty of good faith. This good faith duty was expressed well in Elliott v. Davis, when the court described the duty as follows:

Although it has been said that the lessee has a fiduciary obligation in the exercise of the pooling power, it is submitted that the lessee is not a fiduciary and that the standards that apply to fiduciaries are entirely too strict. This is because the lessee has not undertaken to manage and develop the property for the sole benefit of the lessor. The lessee has substantial interest that must be taken into account and he should not be required to subordinate his own interest entirely to the interest of the lessor. Since his interest frequently conflicts with those of the lessor, however, he must exercise the power in fairness and good faith taking into account the interest of the lessor and lessee.

See Elliott v. Davis, 553 S.W.2d 223, 226-227 (Tex. Civ. App. - Amarillo 1977, writ ref'd n.r.e.) quoting E. Kuntz, The Law of Oil & Gas, §48.3 at 218 (1979). The good faith obligation overlaying the right to pool implies at least the following

practical limitations on the lessee's power:

1. Units must be fairly regular in shape;
2. Units must consist of reasonable productive acreage; and
3. Units must not be formed solely for the purpose of lease preservation.

C. WHO IS THE LESSEE?

1. NOT ORRO - Union Pacific Resources Co. v. Hutchison, 990 S.W.2d 368 (Tex. App. - Austin 1999, pet. denied).
2. MAYBE A FARMOUTOR - Mengden v. Pensula Production Co., 544 S.W.2d 643 (Tex. 1976) held that a farmoutor, who had a reversionary interest, was bound by a pooling instrument executed by his farmouttee; however, the court in Edward M. Jones Oil Co. v. Pend Oreille Oil & Gas Co., 794 S.W.2d 442 (Tex. App. - Corpus Christi 1990, no writ) reached the opposite conclusion.
3. AGENTS AND AFFILIATES - a representative for the record owner must be accurately designated - Pampell Interests, Inc. v. Woole, 797 S.W.2d 392 (Tex. App. - Austin 1990, no writ); Tex. Prop. Code Ann. §5.021.
4. LIENHOLDERS ARE NOT - Wylie v. Hays, 263 S.W. 563 (Com. App. 1924). Texas is a lien state, not a title state.
5. LESS THAN ALL OF THE WORKING INTEREST OWNERS - Neither Edward M. Jones Oil Co. v. Pend Oreille Oil & Gas Co., 794 S.W.2d 442 (Tex. App. - Corpus Christi 1990, no writ) or Celsius Energy Company v. Mid-America Petroleum, Inc., 894 F.2d 1238 (10<sup>th</sup> Cir. 1990) provides a good answer.

D. THE COMMUNITY LEASE

1. DEFINED - A lease is executed by owners of separate tracts. The lessee is entitled to treat all tracts covered by the lease as a single "leased premises". Parker v. Parker, 144 S.W.2d 303 (Tex. Civ. App. - Galveston 1940, writ ref'd).
2. NEGATES THE NON-APPORTIONMENT RULE - Royalty from any well drilled upon or pooled with any tract covered by the lease is paid to all royalty owners covered by the lease, except NPROs who have not ratified. French v. George, 159 S.W.2d 566, 569 (Tex. Civ. App. - Amarillo 1942, writ ref'd).
3. LEGAL CONSEQUENCES BETWEEN LESSORS:
  - (a) Each lessor gives up his right to have his own tract separately developed;
  - (b) Each lessor gives up a right to solely receive royalties from production on such owner's individual tract.
  - (c) Each lessor foregoes a right to have wells drilled on his individual tract, offsetting other wells drilled outside of his tract;
  - (d) Enforcement of implied covenants are not limited to the tract owner's individual tract alone;
  - (e) Implied covenant duties, as between tracts, are eliminated; and
  - (f) Each lessor gives up the right to separately negotiate regarding his interest as to his tract during the life of the oil and gas lease.

Southland Royalty Co. v. Humble Oil & Refining Co., 151 Tex. 324, 249 S.W.2d 914 (Tex. 1952).

E. SURFACE LOCATION, USAGE AND EASEMENTS

1. SURFACE LOCATION AND BOTTOM HOLE LOCATED ON SAME TRACT.

The lessee may, without payment or liability, use so much of the surface as is reasonably necessary for exploration and production of the minerals underlying the land, so long as such use is not negligent and is with "due regard" for pre-existing uses by the surface

owner. *Ball v. Dillard*, 602 S.W.2d 521, 523 (Tex. 1980); *Texaco, Inc. v. Spires*, 435 S.W.2d 550 (Tex. Civ. App. - Eastland 1968, writ ref'd n.r.e.) and *Getty Oil Co. v. Jones*, 470 S.W.2d 618 (Tex. 1971).

2. SURFACE LOCATION AND BOTTOM HOLE LOCATION ON DIFFERENT TRACTS.

Permission of the surface owner is required in order to use the surface of one tract for operations on another tract, absent pooling of the two tracts. *Robinson v. Robbins Petroleum Corp.*, 501 S.W.2d 865 (Tex. 1973). Permission from one undivided co-owner will probably be sufficient. *TDC Engineering, Inc. v. Dunlap*, 686 S.W.2d 346 (Tex. App. - Eastland 1985, writ ref'd n.r.e.). Permission may be required from the owner of the minerals, or its lessee, underlying that surface location. The court may consider such matters as interference with mineral owner's/lessee's rights and sub-surface destruction occasioned by drilling of the horizontal well. See *Humble Oil & Refining Co. v. L & G Oil Company*, 259 S.W.2d 933 (Tex. Civ. App. - Austin, 1953, writ ref'd n.r.e.) and *Chevron v. Howell*, 407 S.W.2d 525 (Tex. Civ. App. - Dallas 1956, writ ref'd n.r.e.). Caution should be exercised not to obtain information concerning the minerals underlying the tract penetrated. See *Phillips Petroleum Co. v. Cawden*, 241 F.2d 586 (5<sup>th</sup> Cir. 1957).

3. REGULATORY ISSUES

The lease line spacing and well spacing issues which exist under Rules 37 and 38 relate only to the horizontal drain hole in the co-relative interval. Therefore, the location of the surface facility on a tract different from the tract where the penetration point is located should not raise any regulatory issues. All that is required to obtain a drilling permit is that the operator have the right to drill on each of the tracts depicted on the plat attached to the application for permit to drill, deepen, plug back or re-enter (RRC Form W-1).

The issues related to surface use and crossing lease lines are probably solved by pooling the tract containing the surface location with the other tracts where the horizontal wellbore will be located. Texas common law holds that the effect of pooling is to erase the lease lines and to create a single lease for the purpose of operating the well, permitting the surface of any tract to be used for the benefit of mineral exploration and production on and from the pooled unit. See *Property Owners of Leisure Land, Inc., et al v. Woolf & MaGee*, 786 S.W.2d 757 (Tex. App. - Tyler 1990, no writ). One note of caution, however, is that ground water, which is part of the surface estate, on one tract cannot be used for the benefit of a fieldwide unit. See *Robinson v. Robbins*, 501 S.W.2d at 870.

F. WAIVER OF PARTITIONING POOLED UNITS

A joint owner of an interest in real property has an absolute right to partition that interest. In the case of producing minerals, partition must be by sale, rather than by partition in kind. Notwithstanding the absolute right to partition, parties can agree to waive that right. The court in *MCEN 1996 Partnership v. Glassell*, 42 S.W.3d 262 (Tex. App. - Corpus Christi 2000, pet. den'd) held that, as a matter of law, the pooling agreements at issue contained a waiver of the right to partition the mineral interest. Some of the language contained in the unit designation reviewed is:

... Shall remain in effect as long as the pooled mineral is being produced or shut-in gas royalties are paid under the terms of the mineral leases and amendments thereto which are included in the pooled unit, or so long as drilling operations or reworking operations are being prosecuted thereon with no more than 60 days between cessation of either of them from time to time thereafter...

...Shall remain in effect for 90 days [after recording in Gonzales County, Texas] and so long thereafter as there is a well within the pooled area capable of producing gas, condensate, distillate, or other liquid hydrocarbons except oil, or producing, drilling, or reworking operations are being conducted thereon with no cessation of more than 60 consecutive dates;

...[The unit was made] pursuant and under the terms and provisions of the oil and gas leases relating and pertaining to each unit created hereby, all to the end that such leases as to each such unit ... are pooled, combined, and unitized for the purpose of producing gas from the Edwards Lime Reservoir ... through any well or wells now or hereafter drilled to,

completed in, and producing from said Edward Lime Reservoir on any unit created hereby.

I hope that including some of the actual language reviewed by the court will help you draft your own pooling agreement/designation of unit that would not be subject to partition.

## II. POOLING AS A CONTRACT

### I. AN OIL AND GAS LEASE IS A CONTRACT AND MUST BE INTERPRETED AS ONE.

Hitzelberger v. Samedan Oil Corp. 948 S.W.2d 497, 503 (Tex. App. - Waco 1997, writ den'd).

In construing an unambiguous oil and gas lease, the court seeks the intention of the parties as expressed in the lease. The writing alone is ordinarily deemed to express the intention of the parties; accordingly, a court will enforce an unambiguous lease as written. Heritage Resources, Inc. v. NationsBank, 939 S.W.2d 118, 121 (Tex. 1996).

Parties to an oil and gas lease must strictly comply with its terms. This principal applies to the pooling clause and all other clauses. Pampell Interest, Inc. v. Wolle, 797 S.W.2d 392, 394, (Tex. App. - Austin, 1990, no writ). Absent express authority, a lessee has no power to pool the lessor's interest with the interest of others. Southeastern Pipeline Co. v. Tichacek, 997 S.W.2d 166, 170, (Tex. 1999); Jones v. Killingsworth, 403 S.W.2d 325, 328 (Tex. 1965).

### B. A LESSEE'S AUTHORITY TO POOL DERIVES FROM THE PROVISIONS IN THE OIL AND GAS LEASE AND IS LIMITED AS STIPULATED IN THE LEASE.

Exxon Corp. v. Atlantic Richfield Co., 678 S.W.2d 944, 947 (Tex. 1984).

A typical pooling clause, anticipating a vertical well, only, contains provisions addressing the following issues:

1. Lessee can pool the leased land with other lands.
2. A pooled oil unit or a pooled gas unit cannot include more than the acres stated, usually 40 or 80 acres for oil and 640 acres for gas, usually plus a 10% tolerance.
3. If government regulation prescribes (read requires) or permits (read allows) a producing allowable based upon greater acreage per well, then the pooled unit may contain the additional acreage prescribed or permitted.
4. The act of pooling requires the Lessee to record a written unit designation in the county of the land leased.
5. Once the written unit designation has been recorded, operation and production from the drillsite tract is considered as if it were operations and production from the non-drillsite tracts.
6. Each royalty owner of the lands pooled is entitled to receive royalty based upon a fraction composed of the acreage contained in his tract divided by the total acreage pooled.

### C. THE POOLING POWER SHOULD BE INTERPRETED BROADLY.

The anticipatory pooling power given the lessee in a oil and gas lease is necessarily broad. Tiller v. Fields, 301 S.W.2d 185 (Tex. Civ. App. - Texarkana 1957, no writ). In the absence of clear language to the contrary, pooling clauses should not be construed in a narrow or limited sense. Texaco, Inc. v. Lettermann, 343 S.W.2d 726, 732 (Tex. Civ. App. - Amarillo 1961, writ ref'd n.r.e.).

However, the courts have also strictly construed provisions of pooling clause against a lessee to determine whether or not the lessee complied with the express authority granted. Jones v. Killingsworth, 403 S.W. 2d 325 (Tex. 1965). The best solution is to have a well drafted pooling clause that clearly gives the lessee broad powers and wide discretion.

### D. ENTIRETY CLAUSE

A typical entirety clause is:

If the leased premises are now or shall hereafter be owned in severalty or in separate tracts, the premises, nevertheless, shall be developed and operated as one lease, and all royalties accruing hereunder shall be treated as an entirety and shall be divided among and paid to such separate owners in the proportion that the acreage owned by each such separate owner bears to the entire leased acreage.

This clause divides the royalty on a surface acreage basis and thus negates the non-apportionment rule. While it

appears fair, in that all royalty owners covered by one lease share proportionately in all royalty, it can lead to complex royalty calculations and other unforeseen problems so that most current lease forms do not include an entirety clause. *Thomas Gilcrease Foundation v. Stanolind Oil & Gas Co.*, 153 Tex. 197, 266 S.W.2d 850 (1954).

A NPRO who ratifies a lease containing an entirety clause is entitled to royalty produced from any tract covered by the lease, not just the NRPO's tract. *Montgomery v. Rittersbacher*, 424 S.W.2d 210 (Tex. 1968).

#### E. PUGH CLAUSE/PARTIAL LEASE TERMINATION

The rule of indivisibility requires that production from a lease, or from any land pooled with the leased land, maintains the lease in its entirety. *Mathews v. Sun Oil Co.*, 425 S.W. 2d 330 (Tex. 1968). In an effort to prevent production from a small portion of leased land maintaining the entire lease, a lawyer in Crowley, Louisiana, Lawrence G. Pugh, in 1947 drafted a clause providing that, when a portion of the leased land was pooled, the non-pooled portion of the leased land terminated, unless the lessee paid delay rentals for a stated period of time for the unpooled land. This type of clause, requiring partial termination of the lease outside the lands held by production, is now commonly called a "Pugh clause", even if the division of the lease between producing and non-producing is not caused by pooling. Personally, I use a term which I consider to be more descriptive, "partial lease termination" in my opinions. The court in *Shown v. Getty Oil Company*, 645 S.W.2d 555 at 560 (Tex. App. - San Antonio 1982, writ ref'd n.r.e.) discussed the history of the "Pugh" clause in a fact situation where only forty acres were pooled out of a 1,080.95 acre lease.

Courts are conflicted as to whether or not actual pooling is required to trigger the Pugh clause. *SMK Energy Corp. v. Westchester Gas Co.*, 705 S.W.2d 174 (Tex. App. - Texarkana 1975, writ ref'd n.r.e.) held that a lease partially terminated even though there was no actual pooling. The court considered the creation of a "drilling unit" as the equivalent of a "unit" in the Pugh clause. The Court in *Mathis v. Texas Intern. Petroleum Corp.*, 627 F.Supp. 759 (W.D. Tex. 1986) held that, with the same facts, the lease did not partially terminate.

#### F. RETAINED ACREAGE CLAUSE

More and more current leases contain provisions requiring the lessee to release undeveloped acreage at some point during the life of the lease. These clauses are sometimes referred to as retained acreage clauses, Pugh clauses, lease termination clauses, continuous development provisions, or release clauses. The issues that arise in determining the amount of acreage allowed to be retained under these clauses most often relate to the issues that arise in determining whether larger pooled units may be formed under the governmental authority pooling clause. I cite three examples of language that can be used. "Upon cessation of the continuous development program as defined herein, this lease shall terminate as to all lands covered hereby save and except ...:

1. "... the amount of acreage prescribed by RRC rules."

This limits the quantity of acres that can be maintained as was required in *Jones v. Killingworth*, supra. This creates a conflict with Rule 86 because the rule provides that additional acreage assigned to horizontal wells is permissive and not mandatory.

2. "... An amount of acreage surrounding each producing well required for obtaining a maximum allowable pursuant to rules of the RRC or the appropriate governmental authority."

The problem created by this language is that a limited capacity horizontal well may need no more acreage than a vertical well in order to receive its maximum allowable. The RRC will not assign an allowable to a well in excess of its capacity to produce. For example, even though Rule 86 may allow an operator to assign 100 acres to the proration unit, the well will only require 80 acres to produce at its capacity. Furthermore, although the well may need all of the acreage allowed at the time of completion to receive its maximum allowable, at the time the retained acreage provision takes effect, the well's producing capacity may have decreased considerably and need significant less acreage for maximum allowable purposes.

3. "...The proration unit assigned to each producing well."

This language limiting the acreage to the "proration unit" for the well may cause the least amount of difficulty for operators and lessees because it avoids the "prescribed" acreage problem discussed above. However, even the term "proration unit" can raise questions because, under Rule 86, the proration unit must be limited to productive acreage.

The goal of the operator is to be certain that the retained acreage clause will allow the retention of all acreage covering the horizontal drainhole and the surface location. Tying the retained acreage amount to the acreage prescribed by RRC

rules or to the maximum allowable may create undue restrictions for the lessee. Instead, the operator should tie the amount of the retained acreage to the acreage that the operators are permitted to assign to the well. A fixed amount of acreage is acceptable as long as the fixed amount is at least equal to or greater than the amount allowed by the RRC rules.

G. BENEFITS OF SUCCESSFUL POOLING

1. Production on any part of the lease included in a pooled unit will extend the term as to all tracts or leases;
2. Commencement of a well on any leased tract or lease included in a pooled unit will excuse the payment of delay rentals on all of the included leases or tracts;
3. The lessee is relieved of the implied covenant of reasonable development of each tract or lease on a tract or lease spaces;
4. Wells may be located in the unit without respect to the individual property or lease line;
5. The lessee is relieved of the obligation to drill offset wells on other tracts covered by the lease or pooled unit;
6. Each lessor relinquishes its right to have their tract or the included part of their lease separately developed.
7. Each lessor relinquishes its right to receive all of the royalties from production from its own tract or lease to the extent included within the unit; and
8. Each lessor relinquishes its right to have wells drilled on its own tract offsetting wells or other tracts covered the lease.

H. JOA AS POOLING AGREEMENT (creates a "working interest unit")

The Joint Operating Agreement has been held to be "in effect a unitization of the tract conveying an interest in realty ... with income to be paid on the basis of each party's acreage contribution to the whole unit." *Gillring Oil Co. v. Hughes*, 618 S.W.2d 874, 875 (Tex. Civ. App. - Beaumont 1981, no writ); see *Whelan v. Placid Oil Co.*, 198 F.2d 39, 42, (5<sup>th</sup> Cir. 1952); *Renwar Oil Corp. v. Lancaster*, 154 Tex. 311, 315, 276 S.W.2d 774, 776 (1955). DOES NOT POOL ROYALTY.

I. EXAMPLES OF UNSUCCESSFUL POOLING

1. COMPLETING WELL AS OIL WELL IS NOT A "DRY HOLE" AS DEFINED IN THE SAVINGS CLAUSE. *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 801-802 (Tex. 1967) involves the unhappy situation where the operator timely pooled four leases, each lease covering a quarter of a section, for a gas well but then, unexpectedly, completed an oil well. The operator, believing his completed oil well would be considered a "dry hole" for the purpose of his savings clause, skidded his rig over and commenced operations on an adjacent quarter and completed a gas well. The lessor filed suit claiming that upon completion of the oil well, all non-drillsite leases terminated. The Supreme Court, following its strict construction philosophy, held that the producing oil well was not a dry hole pursuant to the savings clause and thus the three non-drillsite leases terminated upon completion of the oil well.

The following language is taken from Exxon's Texas Lease form, which is attached hereto as Exhibit A. This is the only language that I am aware of that has been added to any lease form which would have saved the lessee in the Sunac situation:

"Provided that if after creation of a pooled unit, a well or mine is drilled on the unit area, other than on the land covered hereby and included in the unit, which well is not classified as the type of well for which the unit was created (oil, gas or other mineral as the case may be), such well or mine shall be considered a dry hole for the purposes of applying the additional drilling and reworking and resumption of delay rental provisions of Paragraph 6 hereof."

2. CANNOT RATIFY A POOLED UNIT AFTER A SUCCESSFUL WELL HAS BEEN



COMPLETED.

Fletcher v. Ricks Exploration, 905 F.2d 890 (5<sup>th</sup> Cir. 1990) held that a lessee of a fractional mineral interest in a non-drillsite tract within a pooled unit could not join in the unit by ratifying the unit agreement after a successful well had been drilled. In Neugent v. Freeman, 306 S.W.2d 167 (Tex. Civ. App. - Eastland 1957, writ ref'd n.r.e.), a mineral owner knowingly waited two years before ratifying a community lease which had been fully developed. The court held that he waited too long before accepting the pooling offer.

\* \* \* \* \*

Money isn't the root of all evil, but it is a pretty fair measurement of services rendered.

Regarding the restroom door; Incoming traffic has the right-of-way.

Now is a much more powerful word than later. Today is stronger than tomorrow. There is much to do, but so little time.

On a gravestone: Even the undertaker was saddened by his passing.

When you invest your time and effort in helping others who are less fortunate than yourself, no recession or depression can diminish your returns.

### III. THE COMMISSION

#### A. SPACING REQUIREMENTS (Rule 37)

Spacing requirements are adopted for the purpose of limiting the number of wells in locating the wells particular positions to maximize recovery from a field. The rules prescribe minimum distances between a proposed well and any other well drilled in the same area and between the proposed well and property lines. 16 Tex. Admin. Code §3.37 (2000). In the absence of special field rules, new wells are drilled pursuant to statewide Rule 37 which requires that wells be at least 1,200' apart and at least 467' from the property line, lease line, or subdivision line.

Acreage is assigned to the well in accordance with the spacing regulations to form a "drilling unit", which must be designated before a well may be drilled.

#### B. DENSITY REQUIREMENTS (Rule 38)

Density rules require the assignment of a specified number of acres to a well after it has been drilled, creating a "proration unit". The purpose of the density rules is to establish the acreage that wells in a specific field can drain efficiently. Factors such as the permeability and porosity of the reservoir rock are used to determine the drainage area in creating the density requirements for a particular field. Tex. Nat. Res. Code Ann. §86.089(c)(West, 1993). "Porosity" measures the capacity of the rock to hold oil, gas and water. "Permeability" is the measure of how readily fluid flows through the rock. Although drilling permits do not apply to proration units, an operator generally cannot drill a well on less acreage than that required by the density regulations.

#### C. RIGHT OF WAY STRIP DOES NOT DESTROY CONTIGUITY (Rule 39)

Proration and drilling units established for individual wells shall consist of acreage which is contiguous. The operator can request an exception if the acreage to be included in the proration or drilling unit is separated by a long, narrow right of way tract, such as a road or railroad.

#### D. PRODUCTION ALLOWABLES. (Rule 40)

Production allowable refer to the maximum amount of hydrocarbons a well may recover as prescribed by the applicable field rules. Production allowables are design to limit production from a well in order to control the rate of production from the field. The most frequent basis used for determining the allowable is productive surface acres. Thus, an operator must first designate the proration unit and the acreage assigned to it, then certify that the acreage is productive before receiving the well's production allowable.

E. DRILLING UNIT v. PRORATION UNIT v. POOLED UNIT

If a tract is of insufficient size to satisfy the state's spacing or density requirement, lessees will "pool" acreage from different leased tracts, transforming separate leases on separate tracts into a single pooled unit. The grant of a permit to drill a well does not result in the valid pooling of separately owned tracts within the drilling unit. Similarly, the designation of a proration unit does not have the effect of creating a pooled unit. The Railroad Commission has no authority to determine property rights. *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965).

One case that discusses the differences in these three types of units, and gets it right, is *Whelan v. Manziel*, 314 S.W.2d 126 (Tex. Civ. App. - Texarkana 1958, writ ref'd n.r.e.).

F. HORIZONTAL WELLS (Rule 86)

Horizontal wells are initially drilled vertically, and then at a pre-determined point, the drill stem deviates and proceeds horizontally into a the targeted formation. A wellbore can extend across several leased tracts, increasing the likelihood of recovery of minerals. Each tract traversed by the horizontal wellbore is a drillsite tract, and each production point on the wellbore is a drillsite.

The Railroad Commission refers to a "horizontal drain hole well" as any well that consists of one or more horizontal drain holes. 16 Tex. Admin. Code §3.6(a)(4)(2000). A horizontal drain hole is that part of the wellbore that deviates at more or less of a right angle from the vertical wellbore; it begins at the "penetration point", where it penetrates the field at an interval capable of production, and ends at the "terminus point", the point farthest from the penetration point but within the producing interval. See id. §3.86(a)(2), (5), (6), (2000). For purposes of designating a proration unit and allocation production allowables, units are determined by the length of the horizontal displacement between the penetration point and the terminus point, i.e. the horizontal displacement of the drain hole. The displacement of the drain hole must extend at least 100' for the well to be classified as a horizontal drain hole. See id §3.86(a)(4).

I provide a summary of statewide Rule 86 and of the other statewide rules which were amended so as to conform with Rule 86:

1. Statewide Rule 86. Rule 86 adopted effective as of 6/1/1990 applies to all horizontal wells, except for those fields where the Railroad Commission of Texas has prescribed special field rules.

- a. Definitions. It is important in discussing the legal issues related to horizontal drilling, that we adopt a set of common definitions. The definitions adopted by the Railroad Commission in its Rule 86 will be used. They are generally as follows:

- (1) Correlative Interval. The correlative interval is important, because the designation of the top of the correlative interval is related to the definition of penetration point, from which spacing is determined. The correlative interval for the Austin Chalk is normally the entire Austin Chalk interval from the top to the base of the formation, even though operators have now identified at least three separate producing intervals in many areas of the Austin Chalk which are separated by impermeable ash beds.
- (2) Horizontal Drainhole. The portion of the well bore drilled in the correlative interval between the penetration point and the terminus.
- (3) Horizontal Drainhole Displacement. The calculated horizontal displacement of the horizontal drainhole from the penetration point to the terminus.
- (4) Horizontal Drainhole Well. Any well that is developed with one or more horizontal drainholes, having a horizontal drainhole displacement of at least 100 feet.

It should be noted, however, that Rule 86(f)(1) requires the operator to indicate an intent to develop a new or existing well using a horizontal drainhole. Obviously, this definition is too limited for our purposes and perhaps the definition first used by Oryx Energy Company and later adopted by the Oklahoma legislature is more useful (with parenthetical references to Rule 86 definitions added):

A horizontal well is a well in which the horizontal component (the horizontal drainhole displacement) of the gross completion interval in the reservoir exceeds the vertical component (the correlative interval).

- (5) Penetration Point. The point where the drainhole penetrates the top of the

correlative interval.

- (6) **Terminus.** The farthest point required to be surveyed along the horizontal drainhole from the penetration point and within the correlative interval.

Rule 86(f)(3) requires a directional survey from the surface to the farthest point drilled in a horizontal drainhole and no allowable is assigned until a directional survey and survey plot have been filed and accepted by the Commission.

- b. **Special Field Rules.** As of the date of adoption of Rule 86, Commission special field rules for horizontal wells were effective for 13 fields located in Winkler, Frio, Nolan, Gonzales, Sabine, Newton, Polk, Burleson, Jasper, San Augustine, Lee, Fayette, Brazos, Madison, Leon, Grimes, and Wilson Counties, covering Wolfcamp (Winkler), Austin Chalk, Ellenburger (Nolan), Buda and Georgetown formations.

- c. **Size of Proration Units.** The acreage which may be assigned to a horizontal drainhole well for allowable purposes is the amount for a vertical well drilled in the same field, plus additional acreage as follows:

- (1) **For Fields with a Density Rule of 40 Acres or Less:** 20 acres may be added for each 585 feet of horizontal displacement in excess of 100 feet. Thus, for example, on statewide spacing, the proration or drilling unit which may be assigned for a 2000-foot horizontal drainhole displacement is 120 acres.
- (2) **For Fields with a Density Rule Greater than 40 Acres:** 40 acres may be added for each 827-foot increment of horizontal displacement in excess of 150 feet.

See chart contained in Rule 86(d)(1) for additional acreage which may be assigned.

- d. **Surface Location.** The surface location of a horizontal well has no bearing on the acreage included in the proration unit. Spacing, and, thus the size of the proration unit, is measured with respect to the penetration point and the terminus in the correlative interval.
- e. **Maximum Allowable.** The maximum allowable is determined by multiplying the allowable for a vertical well in the same field by a fraction, the numerator of which is the acreage assigned to the well under Rule 86 and the denominator of which is the maximum acreage that may be assigned to the well for proration purposes, not including tolerance acreage.

2. **Other Statewide Rules.** Other rules concerning location and operation of wells have been amended to take into account the effect of Rule 86 or are affected by the operation of Rule 86 for horizontal wells.

- a. **Rule 11.** This rule requires all wells to be drilled as nearly vertical as possible by normal drilling operations. It requires a special permit be obtained to intentionally deviate wells from the vertical. It requires filing of directional surveys. Rule 11 now permits the drilling of horizontal drainholes.

- b. **Rule 37.** Rule 37 is specifically amended by Rule 86 so that surface location is not important for spacing. Rather, the location where the well penetrates the "correlative interval" must be at or more than the minimum distance from another well or property lines. Minimum distance requirements must be observed at all points along the horizontal drainhole in the correlative interval. Railroad Commission Rules do not expressly require the drill site location or the lands traversed by the drainhole prior to the penetration of the correlative interval be included within the proration unit.

- (1) No point closer than 1200 feet to any other well in the same field or closer than 467 feet to any property line.

- (2) What happens if the drainhole encounters the correlative interval closer to the lease line than anticipated?

Because it may be difficult to maintain control of a horizontal drainhole while drilling, after drilling is complete, the operator may find that he has violated the spacing requirements of Rule 37. Rule 86(f)(2) requires an amended application for permit and plat after completion of a horizontal drainhole well. If the Commission determines that the drainhole, as drilled, is "not reasonable" with respect to the drainhole represented on the plat filed with the initial drilling permit application. A post drilling Rule 37 hearing may be required to determine whether or not the well as drilled is substantially in compliance with the original application (See Rule 37(m)(6)).

- c. Rule 38.Rule 38 concerning density remains unaffected as it relates to the minimum acreage required for a well, but the operation of Rule 38 as it relates to maximum density has been preempted by Rule 86.
- (1) The minimum acreage required for a horizontal well is that assigned to a vertical well by Rule 38 or special field rules.
  - (2) Rule 86 allows additional acreage to be assigned to a well, based on the length of the drainhole, so there is apparently unlimited authority to assign additional acreage, so long as that acreage is not assigned to another horizontal well and the acreage is reasonably productive.

\* \* \* \* \*

Always drink upstream from the herd.

When throwing your weight around, be ready to have it thrown around by someone else.

The quickest way to double your money is to fold it over and put it back in your pocket.

#### IV. CATASTROPHES - HOW TO AVOID

##### A. TIMELY RECORDING PERPETUATES THE NON-DRILLSITE TRACTS

Sauder v. Frey, 613 S.W.2d 63 (Tex. Civ. App. - Ft. Worth 1981, no writ)

To solve this problem, amend the pooling clause to provide that pooling is effective when the designation of unit is executed. The pooling clause in Tiller v. Fields, 301 S.W.2d 185 (Tex. App. - Texarkana 1957, no writ) did not require the recording of a designation of unit in order for it to become effective, thus the pooled unit became effective upon execution, irrespective of what was ultimately recorded.

In Humble Oil & Refining Co. v. Kunkel, 366 S.W.2d 236 (Tex. Civ. App. - San Antonio 1963, writ ref'd n.r.e.) the lessee drilled through the primary term but completed a dry hole. Rather than commencing new operations within the 60 day grace period, he pooled the lease with a producing adjacent lease. The court held that this option was not available under the terms of the lease in question. The lesson is to utilize a pooling clause which allows pooling at any time for any reason.

##### B. DESIGNATION OF UNIT MUST BE EXECUTED BY PERSON AUTHORIZED.

Pampell Interests, Inc. v. Woole, 797 S.W.2d 392 (Tex. App. - Austin, 1990, no writ)

Parties signing as agent must comply with the common law rules of establishing agency.

##### C. GOVERNMENTAL REGULATIONS MAY "PRESCRIBE" AND/OR "PERMIT"

Jones v. Killingsworth, 403 S.W.2d 325 (Tex. 1965)

Be aware of pooling clause that allows pooling for acres "prescribed" but does not allow pooling for acres "permitted" by the RRC.

##### D. NUMEROUS "GOOD FAITH/BAD FAITH" ISSUES

###### 1. CANNOT INCLUDE CONDEMNED LAND

Amoco Production Co. v. Underwood, 558 S.W.2d 509 (Tex. Civ. App. - Amarillo 1977, writ ref'd n.r.e.); Hay v. Shell Oil Co., 986 S.W.2d 772 (Tex. App. - Corpus Christi 1999, pet. den'd).

###### 2. CANNOT GERRYMANDER

Amoco Production Co. v. Underwood, 558 S.W.2d 509 (Tex. Civ. App. - Amarillo 1977, writ ref'd n.r.e.) (One well held eight leases totaling 2,252.03 acres!); Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc. 891 S.W.2d 342 (Tex. App. - Amarillo 1994, writ den'd) (The pooled unit was irregular in shape, its diagonal corners being in excess of 11,000' apart, and containing 668.23 acres.).

###### 3. CANNOT IGNORE GEOLOGY

Elliott v. Davis, 553 S.W.2d 223 (Tex. Civ. App. - Amarillo 1977, writ ref'd n.r.e.)

###### 4. DUTY TO UNLEASED MINERAL OWNER

Superior Oil Co. v. Roberts, 398 S.W.2d 294 (Tex. 1966) (Right of an unleased undivided mineral owner to share production depends upon the location of the unit well);

Sun Exploration & Production Co. v. Pitzer, 822 S.W.2d 294 (Tex. App. - Eastland 1991, writ denied) (Owner of one-half minerals in one tract in unitized field held not entitled to royalty because well not on his tract.);

Donnan v. Atlantic Richfield, 732 S.W.2d 715 (Tex. App. - Corpus Christi 1987, writ denied) (Indicates that lessee has no duty to offer the unleased mineral owner a right to participate in a pooled unit);

Kinsey v. Ford, 593 S.W.2d 107 (Tex. App. - Beaumont 1979, writ ref'd n.r.e.) (Lessee colluded with lessor to avoid term NPRI);

Manges v. Guerra, 673 S.W.2d 180 (Tex. 1984) (Mineral owner has fiduciary duty of "utmost fair dealing" in treating NPRO fairly).

5. DUTY TO DRILLSITE NPRO

Brown v. Smith, 174 S.W.2d 43 (Tex. 1943)(NPRO cannot be pooled without owner's consent.);  
Montgomery v. Rittersbacher, 424 S.W.2d 210 (Tex. 1968)(But NPRO can ratify if pooling is to his advantage.);  
Ruiz v. Martin, 559 S.W.2d 839 (Tex. Civ. App. - San Antonio 1997, writ ref'd n.r.e.) (NPRO shared in royalty after ratifying even though the lease had no entirety clause);

Verble v. Coffman, 680 S.W.2d 69 (Tex. App. - Austin 1984, no writ) and  
London v. Merriman, 756 S.W.2d 736 (Tex. App. - Corpus Christi 1988, writ denied) are somewhat confusing and contradictory, but collectively they may require the lessee to notify any NPRO within the pooled unit, or else face a potential argument that the lessee participated in the executive owner's breach of duty in the event the executive/mineral owner fails to notify the NPRO. See Ernest E. Smith, The Standard of Conduct Owed by Executive Right Holders and Operators to the owners of non-participating and non-operating interests, 32<sup>nd</sup> Oil & Gas Inst. 241, 252-55 (1981).

Brown v. Getty Reserve Oil, Inc., 626 S.W.2d 810 (Tex. App. - Amarillo 1981, writ dismissed) holds that a NPRO can ratify a designation of unit and thus receive royalty from the unit well, without being bound by the lease's pooling clause.

In MCZ, Inc. v. Triolo, 708 S.W.2d 49 (Tex. App. - Houston [1<sup>st</sup> Dist.] 1986, writ ref'd n.r.e.) the NPRO received royalty from the first unit well by ratifying the designation of unit, and received royalty from the second well drilled upon his tract that was not proportionately reduced.

6. DUTY TO NON-DRILLSITE NPRO

In DeBenavides v. Warren, 674 S.W.2d 353 (Tex. App. - San Antonio 1984, writ ref'd n.r.e.), non-participating royalty owners did not learn of a lease and designation of pooling until 10 years after the lease was executed and seven years after production was established in the pooled unit. The NPRO were allowed to retroactively ratify the lease, effective as of the date of first production, and to obtain a judgment against the lessors for their share of production, on the grounds that the lessors had violated a duty of "utmost good faith" by failing to notify the NPRO when the lease was first executed. The fact that the lease and the designation of unit were both filed for record was held to be insufficient to discharge the duty to notify the NPRO that they could ratify the leases if they so elected.

Harrison v. Bass Enterprises Production Co., 888 S.W.2d 532 (Tex. App. - Corpus Christi 1994, no writ)(Rejects NPRO's allegation of lessee's fraudulent concealment as basis for tolling statute of limitations on unpaid royalties).

Leopard v. Stanolind Oil & Gas Co., 220 S.W.2d 259 (Tex. Civ. App. - Dallas, 1949, writ ref'd n.r.e.) is the only case I found dealing with NRPOs that had a happy result for the lessee. In Leopard, the court held a NPRO who had previously accepted royalty payments was estopped from challenging the lease at a later time.

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A man who does not read good books has no advantage over the man who can't read them.

Wisdom is the quality that keeps you from getting into situations where you need it.

A man never discloses his own character so clearly as when he described another's.

The future belongs to those who see possibilities before they become obvious.

You must have long-range goals to keep you from being frustrated by short-range failures.

V. THE CASE (Re: Horizontal Pooling)

The Browning case is the first appellate decision discussing horizontal pooling issued from an oil and gas producing state. It is the author's opinion that the case was incorrectly decided because the Texas appellate court interpreted the pooling authority contained in the lease too strictly. However, the case is discussed in detail to illustrate the importance of clear leasehold language and the difficulty/expense of litigating these issues.

Browning Oil Co., Inc. v. Luecke, 38 S.W.3d 625 (Tex. App. - Austin 2000, pet. denied.)  
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A. THE FACTS

Jimmie Luecke and his mother, Leona Luecke executed three oil and gas leases in 1979 to Humble Exploration Company, Inc. which were later assigned to Browning Oil Co., Inc. Each lease covered a separate tract of land in Fayette County as follows:

Tract 1 -	150 acres
Tract 2 -	88.12 acres
Tract 3 -	193.735 acres
	431.855 acres

and provided for a 1/8 royalty. The Plaintiffs owned all of the minerals in Tracts 1 and 3 and 1/2 of the minerals in Tract 2. The leases contained a standard pooling provision which was limited by a "anti-dilution provision" which required that a pooled unit must include at least 60% of the acreage from each tract included within the pooled unit. In 1984, the anti-dilution paragraph was amended to provide that if a pooled unit was too large for the covered tract to constitute 60% of the unit, the unit must be filled "only [with] other lessor owned land" - that is, exclusively with other land owned by the Lueckes - until the adjacent Lueckes-owned land is exhausted. Other restrictions were:

1. Lessees could include non-Luecke land in the pooled units only to the extent necessary to satisfy the Railroad Commission Field Rules.
2. If the applicable Railroad Commission Field Rules offer a choice between spacing requirements of different sizes, lessees must choose the "lesser" units to be formed, minimizing the chances that any unit will ever need to be include non-Luecke land to satisfy the spacing rules.

There is no language specifically limiting the applicability of the anti-dilution provisions to vertical wells, probably because the surge of horizontal drilling in the Austin-Chalk area was still in the future.

On November 2, 1994 representatives from Marathon, recognizing the benefits of horizontal drilling in the Austin Chalk formation, attempted to amend the leases by adding an amendment which would nullify the anti-dilution provisions, allowing lessees the sole discretion to pool any portion of the Luecke's land to create a unit with a horizontal well utilizing the greatest acreage allowable. The Lueckes refused to amend their leases.

Nevertheless, lessees completed two horizontal wells that crossed the Luecke's land:

1. On February 13, 1995 the lessee completed the Jennifer #1 well as a horizontal well that crossed seven separate tracts of land, only one of which belonged to the Lueckes. The vertical portion of the well and a part of the horizontal drain hole are physically located on the Luecke's Tract 2. The lessees attempted to pool 839.18 acres, 268.68 acres which was owned by the Lueckes - 115.82 acres from Tract 1, 87.68 acres from Tract 2, and 65.18 acres from Tract 3 - constituting 32% of the entire unit. Tract 2, the only Luecke tract crossed by the well, comprises 10.44% of the total unit, far less than the 60% specified in the anti-dilution provision.
2. Later in 1995 the lessees completed a second horizontal well, the Hayes #1. The vertical portion of the well is not located on the Luecke's land, but portions of the horizontal drain hole crossed Tracts 1 and 3. The well was drilled on a purported pooled unit consisting of 346.625 acres. Of those acres, 114.86 are attributable to the Lueckes - 78.62 acres from Tract 3 and 36.24 acres from Tract 1 - totaling approximately 30% of the purported unit. The two tracts contain 10.45% and 22.68%, respectively, of the entire unit.

Contending that the two horizontal wells violated the pooling provisions in their leases, the Lueckes filed suit in October, 1995. The case was tried to the court, and the trial court ruled that the lessees had breached the pooling provisions of the leases. The issue of damages was tendered to the jury.

The plaintiffs claimed that because their tracts were not validly pooled, they were entitled to royalty on all production resulting from the two purportedly pooled units. And because the Hayes well crossed two separate tracts of the Luecke's land, they argued that they were entitled to a double full royalty for the total production on that well. Based on these calculations, the total royalty sought by the plaintiffs totaled \$1,283,242.

The lessees/defendants proposed to allocate royalties to the plaintiffs based upon the shared production from the wells that could be attributed to the well plaintiffs' tracts. Plaintiff's expert witness testified as to how production could be allocated to the plaintiffs' land based upon the fractures underlying their land. According to this expert, the Luecke's share of production would result in royalties totaling \$202,421.05, less than the plaintiffs would have received if they had

ratified the purported pooled units.

The court's charge did not expressly adopt either of the proposed theories but generally instructed the jury to assess damages and to consider royalties that "plaintiffs would have received under the terms of the leases if defendants had performed under the leases." The jury assessed total damages of \$833,256.00, attributing the following damages to each tract:

Tract 1 - \$374,965.00  
Tract 2 - \$108,323.00  
Tract 3 - \$349,968.00

Total - \$833,256.00.

Based on the amounts ordered by the jury, it is clear that the jury rejected the lessees' proposed calculations of royalties due. While the jury may have adopted the plaintiffs' theory of damages, the jury awarded the plaintiffs less than the total royalties sought by the plaintiffs.

The trial court found Browning and Marathon jointly and severally liable to the plaintiffs for the total amount found by the jury. The court further rewarded the plaintiffs \$237,964.20 in pre-judgment interest and \$75,000.00 in attorney's fees.

#### B. THE ISSUES

Upon appeal, the appellants/defendants/lessees argued that:

1. The trial court erred in concluding as a matter of law that the lessees failed to comply with the pooling provisions.
2. The trial court erred in failing to submit to the jury the proper measure of damages.
3. The trial court erred in awarding pre-judgment interest.

The Austin court had no trouble concluding that the lessees' pooling violated the pooling provisions of the leases. Resolving the proper measure of damages and the jury charge issues were more difficult.

#### C. THE RESULT

1. The charge to the jury concerning damages.

The court held that the lessees non-compliance with the pooling provisions did not subject them to the damages awarded by the jury. The court held that:

"The proper remedy for a breach of the pooling provisions may not ignore or exceed the ownership interest conveyed under the leases. The Lueckes contracted for a share in royalties based on total production from their land."

An oil and gas lease is both a contract and a conveyance of an interest in real property. See *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 571 (Tex. 1981) (Rights and duties of lessor and lessees are contractual.); *Hitzelberger v. Samedan Oil Corp.*, 948 S.W.2d at 503 (Oil and gas lease is a contract); *W. T. Waggoner Estate v. Sigler Oil Co.* 118 Tex. 509, 19 S.W.2d 27, 28-29 (1929) (Oil and gas involves property rights of lessor and lessee.)

The trial court erred in not instructing the jury as to which of the damage models was an appropriate basis to calculate royalties due the lessors. The trial court only asked the jury to award as damages the royalties the lessors would have been entitled to if the lessees had performed under the leases. As the lessees complained, the jury charge allowed, and perhaps encouraged, the jury to award the Lueckes royalties on oil and gas produced from lands the Lueckes do not own. The charge did not clarify the confusion between awarding breach of contract damages and calculating the royalties due under the lease. Thus, the court held that the charge was fatally defective. The court declined to apply, as the lessors urged, legal principles appropriate to vertical wells that are so "blatantly inappropriate" to horizontal wells and would discourage the use of horizontal well technology. The better remedy, the court stated, was to allow the offended lessors to recover royalties as specified in the lease, compelling a determination of what production can be attributed to their tracts with reasonable probability. See *Ortiz Oil Co. v. Luttis*, 141 S.W.2d 1050, 1053, (Tex. Civ. App. - Texarkana 1940, writ dismissed by agr.) (Fact that exact amount of oil produced cannot be precisely determined is no reason for denying recovery based on jury's approximation.) The court stated that the lessors/Lueckes were entitled to the royalties for which they contracted, no more and no less.

The court also rejected the lessees proposal that royalties should be calculated based upon a hypothetical 80 acre unit. Lessees relied upon the following cases in support of their theory: *Southeastern Pipeline Co. v. Tichacek*, 997 S.W.2d 166 (Tex. 1999), as well as *Amoco Prod. Co. v. Alexander*, 594 S.W.2d 467 (Tex. Civ. App. - Houston [1st Dist.] 1979), *aff'd as modified*, 622 S.W.2d 563 (Tex. 1981) and *Shell Oil Co. v. Stansbury*, 401 S.W.2d 623 (Tex. Civ. App. - Beaumont), *aff'd per curiam*, 410 S.W.2d 187 (Tex. 1966). The court pointed out that these three cases involved breach of the implied duty to protect against drainage, not breach of express contract terms. The parties in these cases were not relying upon provisions in the lease to determine calculation of royalties. The claims in these cases were based upon the fact that there was no production from the lessor/plaintiff's land and the allegation was that the lessees/defendants



had either failed to pool the plaintiffs' land, or failed to drill an offset well to recover minerals that may underline the lessor's land. The court noted that, in these cases, where there was no producing well on the plaintiffs' land from which to measure production, it was logical to use a hypothetical well to measure damages. In contrast, this case involved the determination of royalties for production from horizontal wells that actually crossed the lessors' land. It was undisputed that the lessors' land contributed to the total production from the horizontal drain hole. Therefore, it was not necessary to speculate concerning production from a hypothetical 80 acre well unit. Also, there was no authority under the leases in question to form an 80 acre unit in order to calculate damages. See *Grimes v. LaGloria Corp.*, 251 S.W.2d 755, 761 (Tex. Civ. App. - San Antonio 1952, no writ) (Courts cannot create new well units if not found within agreement of parties).

## 2. The prejudgment interest issue.

Lessee/Browning argued that Section 91.402 of the Natural Resources Code prohibited prejudgment interest in this type of dispute. See Tex. Nat. Res. Code Ann §91.402(b)(West Supp. 2000). The statute provides that payment of proceeds may be withheld without interest when there is:

"A reasonable doubt that the payee: ...(b.) Has clear title to the interest in the proceeds of production." id.

Because this dispute concerned the Luecke's royalty share in production, Browning argued that this exception should apply in this case. The court disagreed stating that the purpose of the statute was to protect royalty owners from intentional payment delays while permitting delays that result from legitimate title disputes. See *Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*, 966 S.W.2d 451, 461, (Tex. 1998)(citing bill analysis.) The primary issue in this case is whether the lessors are entitled to a pro rata share of royalties under the pooling provisions or royalties from all production from their own land. The lessor's entitlement to royalties has never been in dispute. All parties agree that the Luecke's right to receive some royalty is valid. Thus, since there is no legitimate title dispute, there is no excuse to lessee's statutory duty to pay prejudgment interest.

All parties agreed that prejudgment interest, if any, should be computed as simple interest. See *Johnson & Higgins v. Kenneco Energy, Inc.*, 962 S.W.2d 507, 532 (Tex. 1998). The nature of the underlying dispute determines whether a court should apply prejudgment interest under general principals of equity, or under Section 301.002 of the Finance Code. See *Southeastern*, 977 S.W.2d at 401-402, rev'd on other grounds, 997 S.W.2d 166 (Tex. 1999). The two sources for prejudgment interest provide different accrual periods and different interest rates. Acknowledging that on remand the nature of the dispute might change, the court elected to not comment on the appropriate manner of calculating prejudgment interest, except to agree with lessees that prejudgment interest should not be assessed to funds that were deposited into the registry of the court. See *Pegasus Energy Group, Inc. v. Cheyenne Petroleum Co.*, 3 S.W.3d 112, 125 (Tex. App. - Corpus Christi 1999, pet. denied); *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.*, 794 S.W.2d 442, 450 (Tex. App. - Corpus Christi 1990, writ denied).

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Learn by experience - preferably other people's.

Maturity doesn't come with age; it comes with acceptance of responsibility.

Don't be discouraged; everyone who got where he is, started where he was.

Never ask a barber if he thinks you need a haircut.

It don't take a genius to spot a goat, in a flock of sheep.

A well-spent day brings happy sleep.

Leonardo Da Vinci

I do not pray for a lighter road, but for a stronger back.

Phillips Brooks

Hope sees the invisible, feels the intangible, and achieves the impossible.

Anonymous

Make your life a mission - not an intermission.

Arnold Glasgow

You can't stop the waves, but you can learn to surf.

Dr. Jon Kabat-zinn

A faith that hasn't been tested can't be trusted.

Adrian Rogers

It is difficult to steer a parked car, so get moving.

Henrietta Mears

No one is rich enough to do without a neighbor.

Danish Proverb

Worry is the interest paid by those who borrow trouble.

George Lyons

VI. THE CONUNDRUM (Re: Paying Royalty After Horizontal Pooling)

A. PAY ROYALTY ON A SURFACE ACREAGE BASIS.

Pooling clauses as presently drafted require royalty payment on this basis. I understand that this is the basis attorneys presently use to calculate net revenue for horizontal wells.

B. PAY ROYALTY ON PERCENTAGE OF THE HORIZONTAL DRAINHOLE

This would require a calculation of the length of the horizontal drainhole and a determination of the portion of the horizontal drainhole which, between the penetration point and the terminus, is located within the tracts pooled. This is the method suggested by the court in Browning based upon Rule 86.

C. PAY ROYALTY ON A PRODUCTIVE ACREAGE BASIS ALONG THE HORIZONTAL DRAINHOLE.

Obtaining evidence as to productive acreage requires expert testimony. In the Browning case, there was expert testimony by the lessees as they offered evidence to support the royalty owed on both a percentage of the horizontal drainhole basis and a productive acreage upon the horizontal drainhole basis. Obtaining this type of evidence in order to distribute royalty from a horizontal well that is not involved in litigation would probably be prohibitive.

D. CONFUSION OF GOODS

The court in Browning did not go into detail as to the legal basis for the lessor's/plaintiff's claim that they be paid 100% of 200% of the royalty. The theory that the plaintiff's claim and the Browning court denied is called the "confusion of goods doctrine". The concept provides that if the operator cannot determine with reasonable certainty the amount of production coming from each of the tracts penetrated by a horizontal wellbore, then the operator may be required to account to each of the owners of each tract penetrated as if all of the production is allocable to each tract penetrated by the wellbore. Under the confusion of goods doctrine, where goods similar in nature and value, but owned by different parties, are so confused that the property of each owner cannot be distinguished, then the burden is on the party commingling the goods to properly identify the share of each owner. *Humble Oil & Refining v. West*, 508 S.W.2d 812, 818 (Tex. 1974). To meet this burden, the operator would have to show by a preponderance of the evidence and with reasonable certainty the amount of oil and gas produced from each of the tract penetrated by the horizontal wellbore. See *Exxon Corp. v. West*, 543 S.W.2d 667, 673 (Tex. Civ. App. - Houston [1<sup>st</sup> Dist.] 1976, writ ref'd n.r.e., cert. denied 434 U.S. 875); *Humble Oil & Refining v. West*, 508 S.W.2d 812, 819 (Tex. 1974). In the absence of such showing, the owners in each of the separate tracts will be entitled to receive their ownership share in production from the total oil and gas produced from the well. *Mooers v. Richardson Petro. Co.*, 146 Tex. 1974, 204 S.W.2d 606, 608 (1947). An important question is whether the computation of the production allocable to each tract is capable of being established with reasonable certainty. The burden of proof shifts to the operator after proof by the tract owners of their ownership in an unpooled tract together with proof that they did not consent to the commingling of production in the horizontal wellbore.

Pooling solves the allocation of production as it relates to payment of royalty, because the pooling clause normally provides that royalty will be allocated to each tract in the proportion that the surface acreage included in each tract bears to the total surface acreage included in the unit. However, pooling of the tracts penetrated by the horizontal drainhole does not solve the problems arising from the existence of unleased owners, non-participating royalty interest owners, and non-consenting co-tenants. The rights of these parties are not affected by the pooling and, therefore, they continue to pose the same problem for the operator as discussed above, regardless of the existence of pooling. Under the confusion of goods doctrine, the operator could be required to account to each of the separate tract owners as if 100% of the production came from each tract, unless the operator can show "with reasonable certainty" how much production is obtained from each tract.

I have read the briefs by both parties in the Browning case prepared both for the Court of Appeals and the Supreme Court. The lessors, in their petition to the Supreme Court, complained bitterly of the fact that the appellate court's decision requires them to have the burden of proof upon remand to explain how much oil and gas is produced from each of the tracts they own. I am surprised that they believe they have the burden of proof because, as I understand the confusion of goods doctrine, that burden should still be with the lessee.

VI. THE COMPULSORY (FORCED) POOLING ALTERNATIVE

UNDER CONSTRUCTION

\* \* \* \* \*

He who laughs, lasts.

Mary Pettibone

Live so you wouldn't be ashamed to sell the family parrot to the town gossip.

Will Rogers

You can only stumble if you are moving.	Richard P. Carlton
Life is short, and it's up to you to make it sweet.	Sadie Delaney
At the heart of a cyclone tearing the sky is a place of central calm.	Edwin Markham
Gold is tried in fire, and acceptable men in the furnace of adversity.	Seneca
Sit loosely in the saddle of life.	Robert Louis Stevenson
A wise person learns to enjoy things without owning them.	Anonymous
Trying times are not the times to stop trying.	Ray Owne
The best way to destroy your enemy is to make him your friend	

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EXHIBIT A

A copy of this lease is included because it is the only lease in the author's experience that contains the following provisions which are beneficial to lessee:

1. The delay rental and shut-in gas royalty clauses are covenants and conditions;
2. The effect upon the lease of a change in the gas-to-oil-ratio (GOR) is addressed;
3. The lessee is protected in the event he pools for a gas well but completes an oil well; and
4. The savings clause is drafted both broadly and briefly.

062-0222A  
PRODUCERS 88 REV. TEXAS (1-88)  
WITH 40/640 ACRES POOLING PROVISION

OIL, GAS AND MINERAL LEASE

THIS AGREEMENT made this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_,  
between Lessor (whether one or more) whose address is:  
\_\_\_\_\_  
\_\_\_\_\_, Lessee, WITNESSETH: (\$\_\_\_\_\_) in hand paid, of  
the royalties herein provided and of the agreements of Lessee herein contained, hereby  
grants, leases and lets exclusively to Lessee for the purpose of investigating, exploring,  
prospecting, drilling and mining for and producing oil, gas, sulphur, fissionable materials  
and all other minerals (whether or not similar to those mentioned), conducting exploration,  
geologic and geophysical tests and surveys, injecting gas, water and other fluids and air  
into subsurface strata, laying pipelines, establishing and utilizing facilities for the disposition  
of salt water, dredging and maintaining canals, building roads, bridges, tanks, telephone  
lines, power stations and other structures thereon, and on, treat, transport and own said  
minerals, the following described land in \_\_\_\_\_ County, Texas, to-wit:

This lease also covers and includes all land and interest in land owned or claimed by  
Lessor adjacent or contiguous to the land particularly described above, whether the same  
be in said survey or surveys or in adjacent surveys. For the purpose of calculating rental  
payments hereunder, said land is estimated to contain \_\_\_\_\_ acres,  
whether it contains more or less.

2. Unless sooner terminated or longer kept in force under other provisions hereof,  
this lease shall remain in force for a term of ten (10) years from the date hereof (called  
"primary term") and as long thereafter as oil, gas, sulphur, fissionable materials or other  
mineral is produced from said land or land pooled therewith.

3. The royalties to be paid by Lessee are: (a) on oil, \_\_\_\_\_ of that produced  
and saved from said land, the same to be delivered at the wells or to the credit of Lessor  
into the pipelines to which the wells may be connected; Lessee may from time to time  
purchase any royalty oil in its possession, paying the market price therefor prevailing for

1 the field where produced on the date of purchase, and lessee may sell any royalty oil in its  
2 possession and pay Lessor the price received by Lessee for such oil computed at the well;  
3 (b) on gas, including casinghead gas or other gaseous substance, produced from sand  
4 land and sold or used off the premises or for the extraction of gasoline or other product  
5 therefrom, the market value at the well of \_\_\_\_\_ of the gas so sold or used, provided  
6 that on gas sold by Lessee the market value shall not exceed the amount received by  
7 Lessee for such gas computed at the mouth of the well, and on gas sold at the well the  
8 royalty shall be \_\_\_\_\_ of the amount realized by Lessee from such sale; and © on  
9 fissionable materials and all other minerals mined and marketed, one-tenth either in kind  
10 or value at the well or mine, at Lessee's election, except that on sulphur mined or  
11 marketed, the royalty shall be Two Dollars (\$2.00) per long ton. If the price of any mineral  
12 or substance for the purpose of computing royalty hereunder shall not be in excess of the  
13 price which Lessee may received and retain. Lessee shall have free from royalty or other  
14 payment the use of water, other than water from Lessor's wells or tanks, and of oil, gas and  
15 coal produced from said land in all operations which Lessee may conduct hereunder,  
16 including water injection and secondary recovery operations, and the royalty on oil, gas and  
17 coal shall be computed after deducting any so used. If Lessee drills a well on land covered  
18 by this lease or on land pooled therewith, which well is capable of producing oil or gas but  
19 such well is not being produced and this lease is not being maintained otherwise as  
20 provided herein, this lease shall not terminate, whether it be during or after the primary  
21 term, (unless released by Lessee) and it shall nevertheless be considered that oil or gas  
22 is being produced from the land covered by this leased. When the lease is continued in  
23 force in this manner, Lessee shall pay or tender as royalty to the parties who at the time  
24 of such payment would be entitled to receive royalty hereunder if the well were producing,  
25 or deposit to their credit in the depository bank as hereinafter provided a sum equal to 1/12  
26 of the amount of the annual rental payable in lieu of drilling operations during the primary  
27 term on the number of acres subject to this lease at the time such payment is made for  
28 each calendar month, or portion thereof, thereafter during which said well is situated on  
29 said land, or on land pooled therewith, and this lease is not otherwise maintained, or this  
30 lease is not released by Lessee as to the land on which or the horizon, zone or formation  
31 in which the well is completed. The first payment of such sum shall be made on or before  
32 the first day of the calendar month after expiration of ninety (90) days from the date the  
33 lease is not otherwise maintained for all accruals to such date, and thereafter on or before  
34 the first day of each third calendar month for all accruals to each such date. Lessee's  
35 failure to pay or tender or to properly or timely pay or tender such sum as royalty shall  
36 render Lessee liable for the amount due but it shall not operate to terminate this lease.  
37

38 4. If operations for drilling are not commenced on said land or on land pooled  
39 therewith on or before one year from the date hereof, this lease shall terminate as to both  
40 parties, unless on or before such date Lessee shall pay or tender (or make a bona fide  
41 attempt to pay or tender) to Lessor or to the credit of Lessor in  
42 \_\_\_\_\_ Bank at \_\_\_\_\_ the  
43 sum of \_\_\_\_\_ Dollars (\$ \_\_\_\_\_) (herein  
44 called "rental"), which shall cover the privilege of deferring commencement of drilling  
45 operations for a period of twelve (12) months. In like manner and upon like payment or  
46 tender annually, the commencement of drilling operations may be further deferred for  
47 successive periods of twelve (12) months each during the primary term. The payment or  
48 tender of rental under this paragraph and of royalty under this paragraph and of royalty  
49 under Paragraph 3 on any well which is not being produced, hereinafter referred to as  
50 "shut-in-royalty", may be made by check or draft of Lessee mailed or delivered to the  
51 parties entitled thereto or to said bank on or before the date of payment. Such bank and  
52 its successors are Lessor's agent and shall continue as depository for all rental and shut-in-

royalty payable hereunder regardless of changes in ownership of said land, rental or shut-in royalty. If such bank (or any successor bank) should fail, liquidate or be succeeded by another bank or for any reason fail or refuse to accept rental or shut-in royalty, Lessee shall not be held in default for failure to make such payment or tender of rental or shut-in royalty until thirty (30) days after the party or parties entitled thereto shall deliver to Lessee a property recordable instrument naming another bank as agent to receive such payment or tender. If Lessee shall make a bona fide attempt on or before any payment date to pay or deposit rental to a party or parties entitled thereto, according to Lessee's records, or to a party or parties who, prior to such attempted payment or deposit, have given Lessee notice in accordance with subsequent provisions of this lease of their right to receive rental, and if such payment or deposit shall be ineffective or erroneous in any regard, Lessee shall be unconditionally obligated to pay to such party or parties entitled thereto the rental properly payable for the rental period involved, and this lease shall not terminate but shall be maintained in the same manner as if such erroneous or ineffective rental payment or deposit had been properly made, provided that the erroneous or ineffective rental payment or deposit be corrected within thirty (30) days after receipt by Lessee of written notice by such party or parties of such error accompanied by such instruments as are necessary to enable Lessee to make proper payment. Failure to make proper payment or deposit of delay rental as to any interest in said land shall not affect this lease as to any interest therein as to which proper payment or deposit is made. The down cash payment is consideration for this lease according to its terms and shall not be allocated as rental for a period. Lessee may at any time, and from time to time, execute and deliver to Lessor, or to the depository bank, or file for record a release or releases of this lease as to any part or all of said land or of any mineral or subsurface interval or any depths thereunder and thereby be relieved of all obligations as to the released land, mineral, horizon, zone or formation. If this lease is released as to all minerals, horizons, zones and formations under a portion of said land, the delay rental, shut-in royalty and other payments computed in accordance therewith shall thereupon be reduced in the proportion that the acreage released bears to the acreage which was covered by this lease immediately prior to such date.

5. Lessee, at its option, is hereby given the right and power during or after the primary term while this lease is in effect to pool or combine the land covered by this lease, or any portion thereof, as to oil, gas and other minerals, or any of them with any other land covered by this lease, and/or any other land, lease or leases in the immediate vicinity thereof, when in Lessee's judgment it is necessary or advisable to do so in order properly to explore, or to develop and operate the leased premises in compliance with the spacing rules of the Railroad Commission of Texas, or other lawful authority, or when to do so would, in the judgment of Lessee, promote the conservation of oil gas or other mineral in and under and that may be produced from the premises. Units pooled for oil hereunder shall not substantially exceed in area 80 acres each plus a tolerance of 10% thereof, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of 10% thereof, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed or permitted by governmental regulations. Lessee may pool or combine land covered by this or any portion thereof, as above provided as to oil in any one or more strata and as to gas in any one or more strata. Units formed by pooling as to any stratum or strata need not conform in size or area with units as to any other stratum or strata, and oil units need not conform as to area with gas units. Pooling in one or more instances shall not exhaust the rights of Lessee to pool this lease or portions thereof into other units. Lessee shall file for record in the appropriate records of the county in which the leased premises are situated an instrument describing

1 and designating the pooled acreage as a pooled unit; the unit shall become effective as  
2 provided in said instrument, or if said instrument makes no such provision, it shall become  
3 effective upon the date it is filed for record. Each unit shall be effective as to all parties  
4 hereto, their heirs, successors and assigns, irrespective of whether or not the unit is  
5 likewise effective as to all other owners of surface, mineral, royalty or other rights inland  
6 included in such unit or gas well or well or mine for other mineral on the leased premises  
7 and the pooled unit may include, but is not required to include, land or leases upon which  
8 a well or mine capable of producing oil, gas or other mineral in paying quantities has  
9 theretofore been completed or upon which operations for drilling of a well or mine for oil,  
10 gas or other mineral have theretofore been commenced. Operations for drilling on, or  
11 production of oil, gas or other mineral from any part of a pooled unit which includes all or  
12 a portion of the land covered by this lease, regardless of whether such operations from  
13 drilling were commenced or such production was secured before or after the execution of  
14 this lease or the instrument designating the pooled unit, shall be considered as operations  
15 for drilling or production of oil, gas or other mineral from land covered by this lease whether  
16 or not the well or wells or mine be located on land covered by this lease, and the entire  
17 acreage constituting such unit or units, as to oil, gas or other minerals, or any of the, as  
18 herein provided, shall be treated from all purposes except the payment of royalties on  
19 production from the pooled unit, as if the same were included in this lease; provided that  
20 if after creation of a pooled unit, a well or mine is drilled on the unit area, other than on the  
21 land covered hereby and included in the unit, which well is not classified as the type of well  
22 for which the unit was created (oil, gas or other mineral as the case may be), such well or  
23 mine shall be considered a dry hole for purposes of applying the additional drilling and  
24 reworking and resumption of delay rental provisions of Paragraph 6 hereof. If an oil well  
25 or an oil unit, which includes all or a portion of the leased premises, is reclassified as a gas  
26 well, or if a gas well on a gas unit, which includes all or a portion of the leased premises  
27 is reclassified as an oil well, the date of such reclassification shall be considered as the  
28 date of cessation of production for purposes of applying the additional drilling and  
29 reworking and resumption of delay rental provisions of paragraph 6 hereof as to all leases  
30 any part of which are included in the unit other than the leased premises on which the well  
31 is located. For the purposes of computing royalties to which owners of royalties and  
32 payments out of production and each of them shall be entitled on production of oil, gas or  
33 other minerals from each pooled unit, there shall be allocated to the land covered by this  
34 lease and included in said unit (or to each separate tract within the unit if this lease covers  
35 separate tracts within the unit) a pro rata portion of the oil, gas or other minerals produced  
36 from the unit after deducting that used for operations on the unit. Such allocation shall be  
37 on an acreage basis - that is, there shall be allocated to the acreage covered by this lease  
38 and included in the pooled unit (or to each separate tract within the unit if this lease covers  
39 separate tracts within the unit) that pro rate portion of the oil, gas or other minerals  
40 produced from the unit which the number of surface acres covered by this lease, (or in  
41 each separate tract) and included in the unit bears to the total number of surface acres  
42 included in the unit. As used in this paragraph, the words "separate tract" mean any tract  
43 with royalty ownership differing, now or hereinafter, either as to parties or amounts, from  
44 that as to any other part of the leased premises. Royalties hereunder shall be computed  
45 on the portion of such production, whether it be oil, gas or other minerals, so allocated to  
46 the land covered by this lease and included in the unit just as though such production were  
47 from such land. Production from an oil well will be considered as production from the lease  
48 or oil pooled unit from which it is producing and not as production from a gas pooled unit;  
49 and production from a gas well will be considered as production from the lease or gas  
50 pooled unit from which it is producing and not from an oil pooled unit. Any pooled unit  
51 designated by Lessee in accordance with the terms hereof may be dissolved by Lessee  
52 by instruments filed for record in the appropriate records of the county in which the leased



premises are situated at any time after completion of a dry hole or cessation of production of said unit.

6. If lessee shall drill a dry hole or holes on said land, or on acreage pooled therewith, and this lease is not being maintained otherwise as provided herein, or if oil, gas or other mineral is discovered and not produced from any cause, or if the production thereof should cease from any cause, this lease shall not terminate if Lessee commences operations for drilling or reworking within sixty (60) days thereafter and continues drilling or reworking operations on said well or any additional well with no cessation of more than sixty (60) consecutive days, or if it be within the primary term, commences or resumes the payment or tender of rental or commences operations for drilling or reworking on or before the rental paying date next ensuing after the expiration of sixty (60) days from the date of completion of dry hole, or discovery of oil, gas or other mineral, or cessation of production and continues drilling or reworking operations on said well or any additional well with no cessation of more than sixty (60) days. If at any time subsequent to sixty (60) days prior to the beginning of the last year of the primary term and prior to the discovery of oil, gas or other mineral on said land, or on acreage pooled therewith, Lessee should drill a dry hole thereon, no rental payment or operations are necessary in order to keep this lease in force during the remainder of the primary term. If at the expiration of the primary term, oil, gas or other mineral is not being produced on said land, or on acreage pooled therewith, but Lessee is then engaged in drilling or reworking operations thereon or shall have completed a dry hole thereon within sixty (60) days prior to the end of the primary term, this lease shall remain enforce so long as operations on said well or for drilling or reworking of any additional well are prosecuted with no cessation of more than sixty (60) consecutive days, and if they result in the production of oil, gas or other minerals so long thereafter as oil, gas or other mineral is produced from said land or acreage pooled therewith. In the event a well or wells producing oil or gas in paying quantities should be brought in by Lessee or any other operator on adjacent land and within three hundred thirty (330) feet of and draining the leased premises, or acreage pooled therewith, Lessee agrees to drill such offset wells as a reasonably prudent operator would drill under the same or similar circumstances.

7. Lessee shall have the right at any time during or after the expiration of this lease to remove all property and fixtures placed by Lessee on said land, including the right to draw and remove all casing. When necessary for utilization of the surface for some intended use by Lessor and upon request of Lessor or when deemed necessary by Lessee for protection of the pipeline, Lessee will bury pipelines below ordinary plow depth, and no well shall be drilled with two hundred (200) feet of any residence or barn now on said land without Lessor's consent.

8. The rights of either party hereunder may be assigned in whole or in part, and the provisions hereof shall extend to the heirs, successors and assigns; but no change or division in ownership of the land, rentals or royalties, however accomplished, shall operate to enlarge the obligations or diminish the rights of Lessee, including, but not limited to, the location and drilling of wells and the measurement of production; and no change or division in such ownership shall be binding on Lessee until forty-five (45) days after Lessee shall have been furnished by registered U.S. mail at Lessee's principal of business with a certified copy of recorded instrument or instruments evidencing same. In the event of assignment hereof in whole or in part, liability for breach of any obligation hereunder shall rest exclusively upon the owner of this lease or of a portion thereof who commits such breach. In the event of the death of any person entitled to rentals hereunder, Lessee may pay or tender such rentals to the credit of deceased or the estate of the deceased until

1 such time as Lessee is furnished with proper evidence of the appointment and  
2 qualifications of an executor or administrator of the estate, or if there be none, until Lessee  
3 is furnished with evidence satisfactory to it as to the heirs or devisees of the deceased and  
4 that all debts of the estate have been paid. If at any time two or more persons be entitled  
5 to participate in rental payable hereunder, Lessee may pay or tender said rental jointly to  
6 such persons or to their joint credit in the depository bank; or, at Lessee's option, the  
7 proportionate part of rental to which each participant is entitled may be paid or tendered  
8 to him separately or to his separate credit in said depository; and payment or tender to any  
9 participant of his portion of the rental hereunder shall maintain this lease as to such  
10 participant. In event of assignment of this lease as to a segregated portion of said land,  
11 rental hereunder shall be apportionable as between the several leasehold owners ratably  
12 according to the surface area of each, and default in rental payment by one shall not affect  
13 the rights of the other leasehold owners hereunder. If six or more parties become entitled  
14 to royalty hereunder, Lessee may withhold payment thereof unless and until furnished with  
15 a recordable instrument executed by all such parties designating an agent to receive  
16 payment for all.

17  
18 9. Breach by Lessee of any obligation hereunder shall not work a forfeiture or  
19 termination of this lease nor cause a termination or reversion of the estate created hereby  
20 nor be grounds for cancellation hereof in whole or in part. In the event Lessor considers  
21 that operations are not at any time being conducted in compliance with this lease, Lessor  
22 shall notify Lessee in writing of the facts relied upon as constituting a breach hereof, and  
23 Lessee, if in default, shall have sixty (60) days after receipt of such notice in which to  
24 commence compliance with the obligations imposed by this lease. After discovery of oil,  
25 gas or other mineral in paying quantities on said premises, Lessee shall develop the  
26 acreage retained hereunder as a reasonable prudent operator but in discharging this  
27 obligation as to oil and gas it shall in no event be required to drill more than one well per  
28 forth (40) acres of the area retained hereunder plus a tolerance of 10% thereof and  
29 capable of producing oil in paying quantities and one well per 640 acres plus a tolerance  
30 of 10% of 640 acres of the are retained hereunder and capable of producing gas in paying  
31 quantities.

32  
33 10. Lessor hereby warrants and agrees to defend the title to said land and agrees  
34 that Lessee at its option may discharge any tax, mortgage or other lien upon said land,  
35 either in whole or in part, and if Lessee does so, it shall be subrogated to such lien with  
36 right to enforce same and apply rentals and royalties accruing hereunder toward satisfying  
37 same. When required by the state, federal or other law, Lessee may withhold taxes with  
38 respect to rental, royalty and other payments hereunder and remit the amounts withheld  
39 to the applicable taxing authority for the credit of Lessor. Without impairment of Lessee's  
40 rights under the warranty in event of failure of title, if Lessor owns an interest in the oil, gas  
41 or other minerals on, in or under sand land less than the entire fee simple estate, whether  
42 or not this lease purports to cover the whole or a fractional interest, the royalties, shut-in  
43 royalties and rentals to be paid Lessor shall be reduced in the proportion that his interest  
44 bears to the whole and undivided fee and in accordance with the nature of the estate of  
45 which Lessor is seized. Should any one or more of the parties named above as Lessor fail  
46 to execute this lease, it shall nevertheless be binding upon the party or parties executing  
47 same. Failure of Lessee to reduce rental paid hereunder shall not impair the right of  
48 Lessee to reduce royalties.

49  
50 11. Should Lessee be prevented from complying with any express or implied  
51 covenant of this leased, from conducting drilling or reworking operations thereon or on land  
52 pooled therewith or from producing oil, gas or other mineral therefrom or from land pooled

therewith by reason of scarcity or of inability to obtain or to used equipment or material, or by operation of force majeure, any federal or state law or any order, rule or regulation of governmental authority, then while so prevented, Lessee's obligation to comply with such covenant shall be suspended, and Lessee shall not be liable in damages for failure to comply therewith; and this lease shall be extended while and so long as Lessee is prevented by any such cause from conducting drilling or reworking operations on or from producing oil, gas or other mineral from the leased premises or land pooled therewith, and the time while Lessee is so prevented shall not be counted against Lessee, anything in this lease to the contrary notwithstanding.

12. Each singular pronoun herein shall include the plural whenever applicable.

IN WITNESS WHEREOF, this instrument is executed on the date first above written.

LESSOR SOCIAL SECURITY NO. LESSEE SOCIAL SECURITY NO.

STATE OF TEXAS

COUNTY OF \_\_\_\_\_

This instrument was acknowledged before me on the \_\_\_\_ day of \_\_\_\_\_, 1992  
by \_\_\_\_\_.

My Commission Expires: \_\_\_\_\_

Notary Public

STATE OF TEXAS )

COUNTY OF \_\_\_\_\_ )

This instrument was acknowledged before me on the \_\_\_\_ day of \_\_\_\_\_, 1992  
by \_\_\_\_\_.

My Commission Expires: \_\_\_\_\_

Notary Public



# TEXAS VOLUNTARY POOLING



# THE COMMON LAW

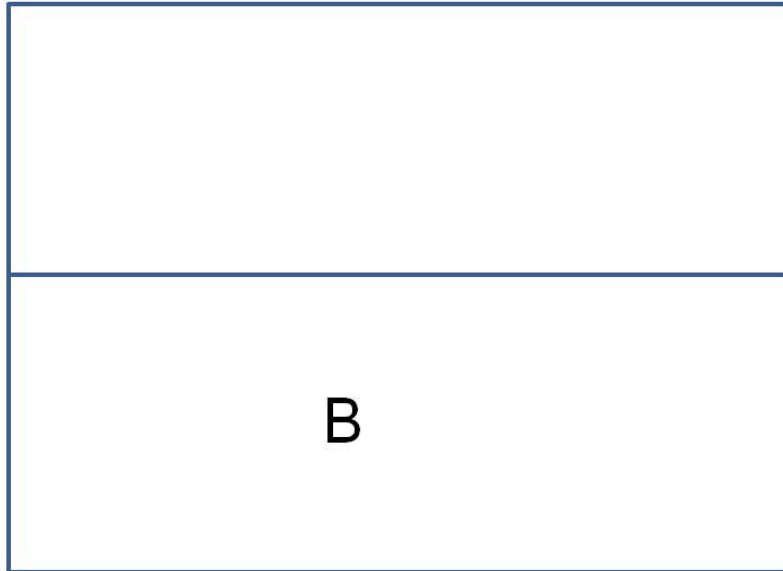
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# THE COMMON LAW

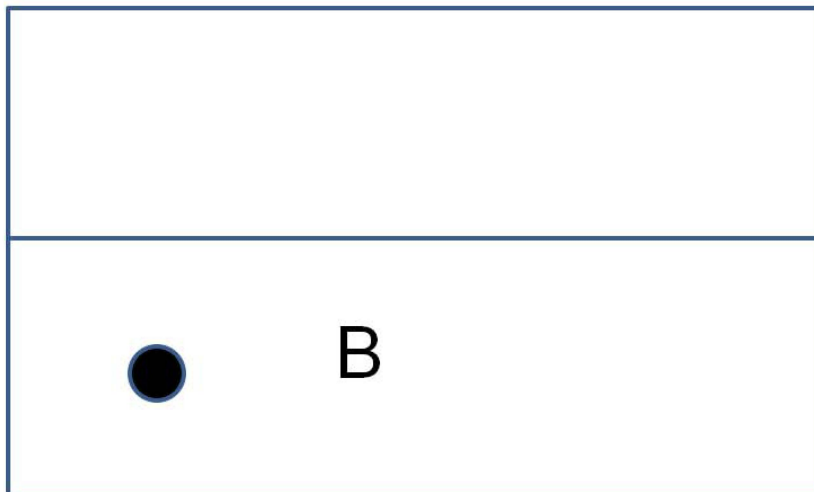
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# THE COMMON LAW

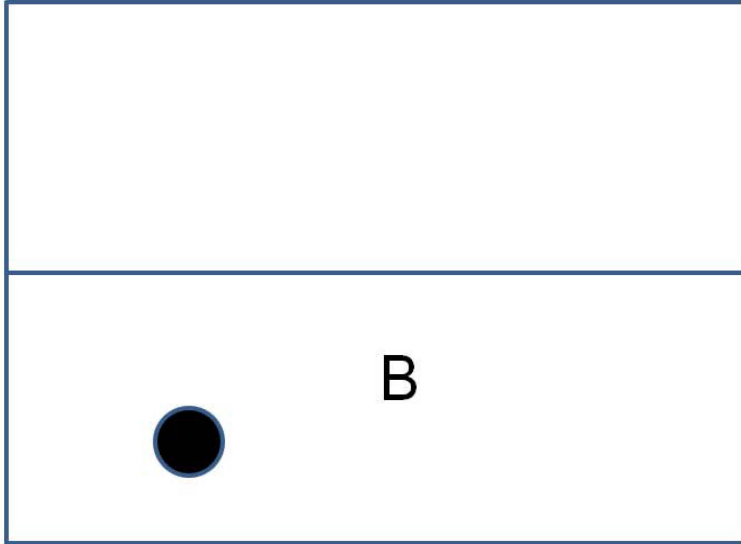
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# THE COMMON LAW

A



Non-Appportionment

Entirety Clause



## A. The Non-Appportionment Rule

Japhet v. McRae – Royalty is paid to the drillsite royalty owner only, unless there is:

1. pooling
2. a community lease
3. an entirety clause in the lease
4. a provision in the deed creating a separate tract that requires apportionment



# THE COMMON LAW

- B. Duty of Lessee to Lessor is Good Faith – not Fiduciary
- C. A Lessee signs the pooling agreement. Who are considered lessees?
  - 1. ORRO – no
  - 2. Farmoutor – maybe
  - 3. Agents and affiliates
  - 4. Lienholders – no

## D. The Community Lease

1. Definition – One lease executed by the mineral owners of multiple tracts. The lessee is entitled to treat all tracts covered by the lease as a single “leased premises”. *Parker v. Parker*.
2. Negates the Non-Apportionment Rule by pooling all mineral owners as a matter of law. The non-apportionment result can be defeated by an express contract.

## E Consents from Surface Owners?

1. Vertical well – Lessee can use as much of the surface as is reasonably necessary as long as the lessee is:
  - a. Not negligent
  - b. Exercises “due regard” for the surface owner’s existing uses.
  - c. Ball v. Dillard; Getty Oil Co. vs. Jones

## E Consents from Surface Owners?

2. Horizontal well - If an operator intends to use the surface of a tract which he does not intend to pool, then he must obtain that surface owner's consent prior to commencing drilling operations.

Robinson v. Robbins Petroleum Corp.

## F. Waiver of Partitioning Pooled Units

A joint owner of an interest in real property has an absolute right to partition that interest. In the case of producing minerals, partition must be by sale, rather than by partition in kind. Notwithstanding the absolute right to partition, parties can agree to waive that right. In *MCEN 1996 Partnership v. Glassell*, the Corpus Christi Court of Appeals held that, as a matter of law, the cumulative provisions in the pooling agreements at issue waived the right to partition.



## G. The Consequence is a Cross-Conveyance?

Veal v. Thomason dealt with determining who were necessary parties in pooling litigation. No Texas case has confirmed that actual title was cross-conveyed. Cross-conveyance is a theory, not a reality.



# THE CONTRACT

- A. A Texas Court will interpret an unambiguous oil and gas lease provision strictly based upon the words actually used, not upon what the parties may have intended but did not express.  
Heritage Resources, Inc. v. NationsBank.  
Absent express authority, a lessee has no power to pool the lessor's interest with the interest of others.  
Southeastern Pipeline Co. v. Tichacek.





# THE CONTRACT

- B. A Lessee's Pooling Authority is limited to the express terms contained in the oil and gas lease. *Exxon Corp. v. Atlantic Richfield Co.* A typical pooling clause addresses the following issues:
1. Authority to pool leased land with other lands for the reasons stated.
  2. Identifies acreage limits for pooling for oil and for gas.
  3. Allows "governmental regulation" to increase acres that can be pooled.
  4. The act of pooling requires the lessee to record a written designation of unit in the county of the land leased.
  5. Once the unit designation is recorded, operations and production from the drillsite are considered operations and production from the non-drillsite tracts.
  6. Each royalty owner pooled is entitled to receive royalty based upon the fraction composed of the net mineral acres contained in his tract divided by the total mineral acres pooled.



# THE CONTRACT

- C. The granting of pooling authority in the lease is interpreted broadly, *Tiller v. Fields*, but the exercise of that authority is often interpreted strictly, *Jones v. Killingsworth*. The best solution is a well-drafted pooling clause granting the lessee broad powers and wide discretion. See Texas Exxon Lease attached as Exhibit A.



# THE CONTRACT

## D. Entirety Clause – Negates the non-apportionment rule.

Royalty is paid on a lease basis, not a tract basis.

Thomas Kilcrease Foundation v. Stanolind Oil & Gas Co.

Most current lease forms do not contain an entirety clause.

## E Pugh Clause/ Partial Lease Termination

The rule of indivisibility requires that production from a lease, or from any land pooled with the leased land, maintains the lease in its entirety. *Mathews v. Sun Oil Co.* A “Pugh clause”, I prefer “lease termination clause”, allows a lease to partially terminate, vertically and/or horizontally, outside of producing acres and formations. *Shown v. Getty Oil Company*



## F. Retained Acreage Clause.

These clauses are sometimes referred to as retained acreage clauses, Pugh clauses, lease termination clauses, continuous development provisions, or release clauses. The result is that leases partially terminate vertically except for the acreage around a producing well, usually described as the acreage within a proration unit, or the number of acres required to obtain a maximum allowable.

There are no proration units where there are no special field rules or where the allocation formula does not include acreage as a factor. Therefore, in those instances, a retained acreage clause that is based upon retention of the acres within a proration unit would be considered ambiguous.

## F. Retained Acreage Clause.

Do not confuse the acres a lessee can pool, which is determined by the authority granted in the pooling clause of the lease, with the acres the lessee can retain after the completion of the continuous drilling program, which is determined by the retained acreage clause.



# THE CONTRACT

## G. JOA as Pooling Agreement (creates a “working interest unit”)

A JOA is a contract between the leasehold owners of leases covering one or more tracts whereby they agree how they will participate in the cost of drilling a well and in the proceeds from production of the well.

Typically a JOA covers the land upon which the first well is drilled upon the leases. However, a JOA can cover the lands covering the drilling of multiple wells, and this is called a “working interest unit”. A JOA does not pool royalty. *Gillring Oil co. v. Hughes*

## H. Benefits of Successful Pooling

1. Each lessor relinquishes his right to have his tract developed and to receive all royalties from his tract.
2. Commencement of drilling and other operations on one tract benefit all tracts, and excuse the payment of delay rentals.
3. Production on any tract extends the primary term of all leases pooled.
4. Wells may be located within the pooled unit without respect to the individual property or lease lines and the lessee is relieved of its obligation to drill offset wells within the pooled acreage.





# THE CONTRACT

## I. Examples of Unsuccessful Pooling.

1. When lease is pooled for gas, completion of an oil well is not a “dry hole”. *Sunac Petroleum Corp. v. Parkes*.
2. Non-drillsite mineral owners or lessee cannot ratify a pooled unit after a successful well has been completed. *Fletcher v. Ricks Exploration*.

## A. Spacing Requirements – Rule 37

Spacing determines the minimum distance a well must be from tract and lease lines. If special field rules have been adopted, the field rules will prescribe the minimum distance. In the absence of special field rules, the statewide spacing rule is 467' from the property, lease or subdivision line, and at least 1,200' between wells. Acreage is assigned to a well in accordance with the spacing regulations to form a “drilling unit”, which must be designated before a well may be drilled.

## B. Density Requirements – Rule 38

Density rules prescribe the number of acres attributed to a well after it has been drilled, thus creating a “proration unit”. Typical density rules would require 40 or 80 acres for an oil well and 320 or 640 acres for a gas well. A “proration unit” has no title consequence unless it is included as a limitation in a retained acreage clause.

## C. Right of way strip does not destroy contiguity - Rule 39.

Drilling and proration units for individual wells shall consist of tracts which are contiguous. If the tracts are separated by along narrow strip, such as a road or railroad, the operator can obtain an exception.

## D. Production Allowables – Rule 40

The term “production allowable” refers to the quantity of hydrocarbons a well may produce consistent with applicable field rules. The RRC regulates allowables in order to control the rate of production from a field. Typically, oil and gas wells are allowed to be produced at a 100% allowable (Absolute Open Flow, or AOF). The most frequent basis used for determining the allowable is productive surface acres. Thus, an operator must first designate the proration unit describing the acreage assigned, then certify that the acreage is productive, before receiving the wells production allowable.





# THE COMMISSION

## E Drilling Unit – Proration Unit – Pooled Unit

The grant of a permit to drill a well, which creates a drilling unit, does not pool separately owned tracts. The designation of a proration unit does not create a pooled unit. Pooling is a matter of contract authorized and limited by the pooling clauses of the leases pooled. The RRC has no authority to determine property rights. *Jones v. Killingsworth*. A case that discusses these differences is *Whelan v. Manziel*.



# The Commission

## F. Horizontal Wells – Rule 86

My paper contains a summary of Rule 86 as originally issued.

## A. Timely recording perpetuates the non-drill site tracts.

In the usual event where the pooling clause does not provide the time when the pooling becomes effective, pooling is effective when the pooling instrument is recorded. *Sauder v. Frey*. If the pooling clause does not require that it be recorded, it is effective upon execution. *Tiller v. Fields*. I recommend that the pooling clause state that it is effective upon the date provided in the pooling instrument.



- B. Designation of Unit must be executed by the person authorized.

The only person expressly authorized is the lessee. If someone other than the lessee executes the pooling instruments, the pooling instrument should reflect that the third party is acting as the agent for a lessee.  
Pampell Interest, Inc. v. Wbole.

## C. Government Regulations may “prescribe” and/or “permit”.

Field Rules sometimes provide that they “prescribe” (require) so many acres be attributed to a well, while the lessee is “permitted” (allowed) to attribute additional acreage to a well. Be aware that many pooling clauses allow the lessee to pool as “prescribed” by the RRC, but not as “permitted” by the RRC.  
Jones v. Killingsworth

## D. Some “good faith/bad faith” issues.

1. Cannot include condemned land. *Amoco Production Co. v. Underwood*.
2. Cannot gerrymander. *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*,
3. Cannot ignore geology. *Elliott v. Davis*.

## E Duty of mineral owner/lessee to unleased mineral owner.

1. Drillsite tract – carry unleased mineral owner in drillsite until payout. *Superior Oil Co. v. Roberts*.
2. No duty to offer unleased mineral owner right to participate in a pooled unit. *Donnan v. Atlantic Richfield*.
3. Non-drillsite tract – can be ignored after well completed. *Fletcher v. Ricks Exploration*.

## F. Duty to drillsite NRPO

Cannot be pooled without owners consent. Brown v. Smith. Can ratify lease or pooling agreement, or not ratify anything, based upon its own self interest. MCZ, Inc. v. Triolo.

## G. Duty to Non-Drillsite NPRO.

Allowed to ratify at any time. May or may not receive proceeds from first production. DeBenavides v. Warren.

NPRO nearly always wins.





# CALCULATING ROYALTY WHERE NPRI IN DRILLSITE

Lease – 3/16 R

NPRI of 1/16 of O&G  
in drillsite

## No Ratification

$$\text{MO} - 3/16 \times 1/4(\text{TF}) = 3/64$$

$$\text{NPRI} - 1/16 \times 8/8 = 4/64$$

$$\text{Rpaid to MO} = 0$$

.	

## Ratification

$$\text{MO} - 3/16 \text{ of } 1/4(\text{TF}) = 3/64$$

$$\text{NPRI} - 1/16 \text{ of } 1/4(\text{TF}) = 1/64$$

$$\text{Rpaid to MO} = 2/64$$



# CALCULATING ROYALTY WHERE NPRI IN DRILLSITE

Lease – 3/16 R

NPRI of 1/16 of the R  
in drillsite

.	

## No Ratification

MO – 3/16 x 1/4(TF) = 3/64

NPRI – 1/16 x 3/16 = 3/256

Rpaid to MO – 3/64 (-) 9/256

12/256 (3/64)

## Ratification

MO – 3/16 of 1/4(TF) = 3/64

NPRI – 1/16 of 3/64 = 3/1024

Rpaid to MO – 15/16 of 3/64 = 45/1024

48/1024 (3/64)





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# THANK YOU

## QUESTIONS?

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